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TAXATION

by

J. David Tracy*

I. INHERITANCE TAXES

A. *The Additional Inheritance Tax*

During this survey period the court of civil appeals decided one of the rare cases construing the additional inheritance tax statute.¹ The additional inheritance tax imposed by article 14.12² is designed to absorb the credit allowed against the federal estate tax for state death taxes. Although labeled an "additional inheritance tax," in reality, article 14.12 imposes a transfer tax, and, thus, is an estate tax.³ The additional inheritance tax is correlated with the basic inheritance tax⁴ for three possible situations. First, if the basic inheritance tax equals or exceeds the additional inheritance tax, no further amount is due.⁵ Second, if there is no basic inheritance tax, only the additional inheritance tax is due the state.⁶ Finally, if the basic inheritance tax is less than the additional inheritance tax, an amount equal to the additional inheritance tax is due the state.⁷

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1. *Citizens Nat'l Bank v. Calvert*, 515 S.W.2d 142 (Tex. Civ. App.—Austin 1974, writ granted).

2. TEX. TAX.-GEN. ANN. art. 14.12 (1969).

3. *Strauss v. Calvert*, 246 S.W.2d 287 (Tex. Civ. App.—Austin 1952, writ ref'd n.r.e.). See also TEX. ATT'Y GEN. OP. No. V-402 (1947). For a discussion of the burden of the additional inheritance tax as between the beneficiaries of the estate see Comment, *Apportionment of Death Taxes: A Comprehensive Survey with Proposed Statute*, 45 TEXAS L. REV. 1348, 1352-55 (1967).

4. The "basic inheritance tax" is imposed by TEX. TAX.-GEN. ANN. arts. 14.01-11 (1969), and has been construed by the Texas courts as a tax "on the privilege of succession" and not "on the property which passes" from the decedent. *Cahn v. Calvert*, 159 Tex. 385, 321 S.W.2d 869 (1959); accord, *State v. Hogg*, 123 Tex. 568, 70 S.W.2d 699, *aff'd on rehearing*, 72 S.W.2d 593 (Tex. Comm'n App. 1934, opinion adopted); *Jones v. State*, 5 S.W.2d 973 (Tex. Comm'n App. 1928, recommendation approved); *Walling v. Hubbard*, 389 S.W.2d 581 (Tex. Civ. App.—Houston 1965, writ dismissed n.r.e.); *Norton v. Jones*, 210 S.W.2d 820 (Tex. Civ. App.—Dallas 1948, writ ref'd); *Bethea v. Sheppard*, 143 S.W.2d 997 (Tex. Civ. App.—Austin 1940, writ ref'd).

5. TEX. TAX.-GEN. ANN. art. 14.12(B) (1969). If we assume the basic inheritance tax is \$10,000.00 and the additional inheritance tax is \$8,000.00, the amount due the state is \$10,000.00.

6. TEX. TAX.-GEN. ANN. art. 14.12(C) (1969); see *Sinnott v. Gidney*, 159 Tex. 366, 322 S.W.2d 507 (1959); TEX. ATT'Y GEN. OP. No. C-403 (1965). For example, if due to the exemptions provided in TEX. TAX.-GEN. ANN. arts. 14.02-06 (1969), no basic inheritance tax is due, but the additional inheritance tax is determined to be \$3,000.00, the amount of tax due to the State of Texas is \$3,000.00.

7. See TEX. TAX.-GEN. ANN. arts. 14.12(A), (E) (1969). For example, if the basic inheritance tax is \$4,000.00 and the additional inheritance tax is \$6,000.00, the amount of tax due the State of Texas is \$6,000.00. Technically, the total tax in this situation is composed of \$4,000.00 in basic inheritance taxes and \$2,000.00 in additional inheritance taxes. See Comptroller's Ruling No. 30-0.09, CCH [TEXAS] INH. EST. & GIFT TAX REP. ¶ 2500 (1973).

In *Citizens National Bank v. Calvert*⁸ the court was first concerned with the issue of whether article 14.12 imposed any tax at all, since it referred to the Revenue Act of 1926. Secondly, if the statute were still operative, then the court had to consider whether the comptroller's method for assessing the additional inheritance tax for a decedent's estate located partly within and partly without the State of Texas was proper. After a discussion of the history of the credit against the federal estate tax and the state statutes enacted to take advantage of that credit, the court concluded that article 14.12 imposed a valid tax. Even though the Texas statute refers only to the credit as determined under the Revenue Act of 1926, it is clear that the credit provisions of the 1926 Act were carried forward into the Internal Revenue Code of 1939 and the Internal Revenue Code of 1954, so that there has been no need to amend the Texas statute.⁹ Further, since 1965, the definitions portion of the inheritance tax statute has defined the "Revenue Act of 1926" to include "amendments and revisions thereto."¹⁰

Having determined that article 14.12 imposes a valid tax, the court of civil appeals then addressed itself to the more intriguing inquiry into the method of calculating the "net estate in Texas" for the purpose of determining the portion of the federal credit for state death taxes apportioned to the Texas estate. The pertinent part of the statute provides:

[S]aid amount of Federal [credit] . . . shall be determined by multiplying the total Federal [credit] on the entire estate by a percentage which shall be the same percentage as the percentage of the net estate located in Texas is to the total net estate of the decedent, wherever located, before deducting specific exemptions.¹¹

8. 515 S.W.2d 142 (Tex. Civ. App.—Austin 1974, writ granted).

9. INT. REV. CODE OF 1954, § 2011(d) provides: "The basic estate tax and the estate tax imposed by the Revenue Act of 1926 shall be 125 percent of the amount determined to be the maximum credit provided by subsection (b). The additional estate tax shall be the difference between the tax imposed by section 2001 or 2101 and the basic estate tax."

The import of § 2011(d) is explained in R. STEPHENS, G. MAXFIELD & S. LIND, *FEDERAL ESTATE AND GIFT TAXATION* 3-7 (1974):

[T]he 1926 tax was continued as the 'basic tax,' which served to determine the amount of the credit, and an 'additional tax' was separately imposed, against which no credit for state death taxes was allowed. . . .

[T]his situation continued until the enactment of the Internal Revenue Code of 1954. The present rules represent a substantial simplification.

However, partly for the benefit of the state statutes that are geared to the federal basic tax, the present statute includes a definition of 'basic' and 'additional' taxes in Section 2011(d). Since the maximum credit provided in Section 2011(b) is in effect 80 percent of the old 'basic' tax,²¹ that tax is now defined as 125 percent of the maximum credit. The additional tax is defined as the difference between the basic tax and the tax imposed by the 1954 Code.

21. The credit table set out in I.R.C. § 2011(b) reflects the fact that an exemption of \$100,000 was allowed in determining the net estate for purposes of the old 'basic' tax, while a deduction of only \$60,000 is allowed in computing the 'taxable' estate for current estate tax purposes.

See generally C. LOWNDES & R. KRAEMER, *FEDERAL ESTATE AND GIFT TAXATION* 510-15 (1962).

10. TEX. TAX.-GEN. ANN. art. 14.00A(g) (1969).

11. *Id.* art. 14.12(D) (emphasis added). The early cases construing this provision did not answer the question of how the "net estate" was to be calculated, although clearly the net estate situated in Texas and the net estate wherever situated was used

Clearly, where the entire estate is situated in Texas, the emphasized language presents no problem, as the appropriate percentage would be 100 percent. This was not the situation in *Citizens National Bank* wherein the decedent, an Illinois resident, had devised mineral properties in Texas to certain charities. The decedent's gross estate wherever situated was \$2,745,821.62 and the gross estate within Texas was \$604,536.50. The estate was allowed a credit for state death taxes of \$85,738.59 under section 2011 of the Internal Revenue Code.¹²

The comptroller argued that the State of Texas was entitled to 22.0166 percent of the \$85,738.59 federal credit, or \$18,876.72, as an additional inheritance tax. To arrive at this figure, the comptroller first determined the percentage obtained by dividing the value of the *gross estate* in Texas by the value of the *gross estate* wherever situated.¹³ This figure, 22.0166 percent, was applied to the total deductions allowed on the federal estate tax return, with the resultant product being subtracted from the decedent's gross estate in Texas to yield \$397,945.68, which was 22.0166 percent of the net estate of \$1,807,480.44 wherever situated. This same figure of 22.0166 percent was then multiplied by the total federal credit for state death taxes to obtain the portion of that credit allocable to Texas. Thus, the net effect of the comptroller's computations is that deductions from the decedent's gross estate for federal estate tax purposes are not apportioned to the various states.¹⁴

for the purposes of these calculations. See *Simco v. Shirk*, 146 Tex. 259, 206 S.W.2d 221 (1947).

12. INT. REV. CODE OF 1954, § 2011.

13. The comptroller's computation was as follows:

1. Total gross estate	\$2,745,821.62
2. Portion of total gross estate situated outside Texas	\$2,141,285.12
3. Texas gross estate (Item 1 less Item 2)	604,536.50
4. Percentage of Texas gross estate to total gross estate (Item 3 divided by Item 1)	22.0166%
5. Total net estate wherever situated	\$1,807,480.44
6. Taxable estate for federal estate tax purposes (Item 5 less \$60,000.00 exemption)	1,747,480.44
7. Federal credit for state death taxes	85,738.59
8. Portion of federal credit for state death tax allocated to Texas (Item 7 multiplied by Item 4)	\$18,876.72

These calculations become more significant when correlated with Schedule C of Form 30-1.02, Texas Inheritance Tax Return (Non-Resident). On that schedule it is clear that the only deductions viewed as allowable by the comptroller in calculating the net estate wherever situated are funeral expenses, administration costs, debts, and mortgages. The marital deduction, charitable deduction, and specific exemption (\$60,000.00) are taken into account only for the purposes of determining the decedent's taxable estate for federal estate tax purposes. However, from the facts in *Citizens Nat'l Bank* the \$584,579.00 charitable bequest of Texas mineral property *has been deducted* in determining the net value of the estate wherever situated. This is verified by the calculation showing that the \$85,738.59 federal credit for state death taxes requires a taxable estate for federal estate tax purposes of \$1,747,480.44. This latter figure is \$1,807,480.44 (the net estate wherever situated including a deduction for the charitable bequest) less the specific exemption of \$60,000.00.

14. The court of civil appeals stated:

The Comptroller's answer to this argument is that the entire estate of decedent, wherever located, is subject, to the federal estate tax laws and it is through the entire estate that the federal credit for state death taxes is produced; since the mineral properties in Texas, which constituted the charitable bequest, were included in the federal gross estate, which produced a federal credit for state death taxes, the State of Texas is entitled to its proportionate share of the federal credit.

515 S.W.2d at 146. See also Comptroller's Ruling 30.09, CCH [TEXAS] INH. EST. &

The representative of the decedent's estate, on the other hand, argued that to determine the additional inheritance tax correctly, the Texas gross estate is first reduced by those deductions properly attributable thereto. The net value thus obtained when compared to the decedent's net estate wherever situated was 1.1042 percent, to yield an additional inheritance tax of \$308.19.¹⁵ Thus, it was the estate's position that since the Texas mineral properties were devised to charity, they should be eliminated from the calculation of the decedent's net estate situated in Texas.¹⁶

Against this backdrop, the court of civil appeals accepted the comptroller's view of the statute, stating that under his computational method "the percentage relation of the property within Texas to the entire estate wherever located . . . does not do violence to either the state statute or the federal code, but rather achieves the purpose of the statutes to permit the state to take full advantage of the credit allowed for state death taxes."¹⁷

Since the Texas Supreme Court has agreed to hear arguments on this case, the estate has another opportunity to prevail.* In the author's opinion, the supreme court might well differ with the lower court's conclusion on one or more of the following bases:

1. Regardless of the previous construction placed on article 14.12 by the comptroller's office and the Texas Attorney General, the statute is clear on its face as to the computational method to be used. This method is based on the percentage of the *net estate* situated in Texas as compared to the *net estate* wherever situated.¹⁸

GIFT TAX REP. ¶ 2500 (1973); TEX. ATT'Y GEN. OP. No. M-1093 (1972) (wherein the Texas Attorney General ruled in favor of the comptroller's view of TEX. TAX.-GEN. ANN. art. 14.12 (1969) based on the facts of *Citizens Nat'l Bank*); Payne, *State Inheritance and Estate Tax Considerations in Estate Planning*, in TEXAS INSTITUTES 8TH ANN. TAX. CONF. 79, 113-22 (1960).

15. The estate's computation of the additional inheritance tax would be as follows:

1. Texas gross estate	\$604,536.50
2. Deductions attributable to Texas gross estate (charitable bequests)	584,579.00
3. Net estate in Texas	19,957.50
4. Net estate wherever situated	\$1,807,480.44
5. Percentage of Texas net estate to total net estate wherever situated (Item 3 divided by Item 4)	1.1042%
6. Federal credit for state death taxes	85,738.59
7. Portion of federal credit for state death taxes allocated to Texas (Item 6 multiplied by Item 5)	946.73

From the \$946.73 figure there must be subtracted the basic inheritance tax which had already been paid. Since the estate argued that only \$308.19 in additional inheritance taxes were due, the amount of basic inheritance tax already paid must (of necessity) be \$638.54.

16. The estate's argument was that,

[s]ince no part of funeral and administrative expenses, . . . and no debts of decedent, were paid or were payable out of the surface and mineral properties in Texas, and except for the mineral properties in Texas, no part of the charitable bequests were paid or payable out of any part of the gross estate located in Texas, it was improper for the Comptroller to subtract from the estate within Texas a percentage of the federal deductions.

515 S.W.2d at 146. This argument correlates with the calculation of the basic inheritance tax, as charitable bequests are exempt under TEX. TAX.-GEN. ANN. art. 14.015 (1969).

17. 515 S.W.2d at 147.

* Editor's Note: The Texas Supreme Court reversed the judgment of the court of civil appeals. 527 S.W.2d 175 (Tex. 1975).

18. In determining the deductions to be charged to the properties situated within

2. The effect of the comptroller's method of determining the additional inheritance tax allows the State of Texas to tax a non-resident decedent's real property and tangible property not situated in Texas, and intangible property for which Texas does not provide any "benefit and protection." Since Texas does not have the jurisdictional power to levy an additional inheritance tax on these items of property, the tax is void.¹⁹

3. To ascertain the net estate situated in Texas, it is first necessary to determine the net estate for federal estate tax purposes (the denominator of the equation under article 14.12). The federal net estate is then apportioned to the various states from which the property comprising that figure arose. After this process has been completed, the percentage of the net estate situated in Texas as compared to the total net estate wherever located is determined. Theoretically, the result of this computation will be the same as that obtained in recommendation 1 above.²⁰

B. *Inheritance Tax Division of the Comptroller's Office*

Under the guidance of Karen Johnson, the new director of the inheritance tax division of the comptroller's office, a streamlining of the administration of the Texas inheritance tax has begun.²¹ The impetus for this change originated from a mandate issued by Comptroller Bob Bullock in January 1975, that procedures within the division be simplified.²² In response to this requirement, goals were set to solve present problems and to identify other needed changes.

Policy Considerations. For the first time, an extensive training program has been initiated for the staff examiners, including a course in estates and trusts. Coupled with this is the development of internal resource material for the examiners. The division is also attempting to remedy the lack of communication with representatives of the decedent's estate. In addition to deleting or streamlining unworkable rules, a compilation of the division's rules and internal procedures is being prepared. Representatives of a decedent's estate are being notified of any action which has been commenced with regard to a particular estate. Further, a brochure is being prepared for publication which will answer general questions about the Texas inheritance tax.

and without Texas, it would seem that certain administration expenses (such as office overhead) would not be attributable to any particular property. Thus, unless these expenses were charged solely to the estate situated in the domiciliary state, a portion thereof must be charged to the various states in which the property is situated.

19. Compare TEX. ATT'Y GEN. OP. No. O-2964 (1940) with *id.* O-4752 (1942). See generally Guterman, *Revitalization of Multiple State Death Taxation*, 42 COLUM. L. REV. 1249 (1942); Marsh, *Multiple Death Taxation in the United States*, 8 U.C.L.A.L. REV. 69 (1961).

20. In considering this argument, it should be noted that the term "net estate" in the additional inheritance tax provisions has been construed to have the same meaning as it had in the federal statutes. *State v. Weiss*, 141 Tex. 303, 171 S.W.2d 848 (1943).

21. The author wishes to express his gratitude to Karen Johnson for graciously providing the resource material upon which the textual discussion of the internal procedures within the inheritance tax division is based.

22. Letter from Karen Johnson, Director of the Inheritance Tax Division of the Comptroller's Office, to J. David Tracy, Nov. 28, 1975.

The inheritance tax division is also instituting an audit selection program to use auditors' time more efficiently and to select estates that have grossly undervalued assets and those which would produce the greatest revenue. Procedures are also being developed to determine the type and extent of audits to be performed on selected estates. At the present time the division is studying the feasibility of utilizing field audits to determine the valuation of assets which cannot be adequately determined from a desk audit.

One of the major problems still facing the inheritance tax division is the method of closing larger estates. In the past, after the federal government's audit of these large estates was complete, the Internal Revenue Service furnished the division with copies of the final figures on each estate. From these the division was then able to determine whether the estate owed the state more money. At the present time, the state does not have a cooperative agreement with the federal government to exchange data, and, therefore, all estates large enough for federal audit must be held in an open file. The current procedure dictates that the estate representative must submit to the division audit changes by the Internal Revenue Service before the estate will be closed and a receipt issued for taxes paid. This procedure has resulted in a tremendous increase of estates which have not been finalized by the state, and consequently, the state may suffer a great loss of revenue unless independent audits are made by the division or a cooperative exchange of data agreement is signed with the federal government.

Returns, Reports, and Waivers. One of the more important changes in the inheritance tax division was the development of Form 2B30-4.50 (June, 1975), Inheritance Tax Small Estate Return (Resident). Where the gross estate is under \$60,000.00 or nontaxable, a one-page (front and back) form is now required to be used.²³ Not only has the new form made it easier for estate representatives to report, but it has also reduced the volume of mail and paperwork in the division.

Another much needed procedure was instituted with the promulgation of Form 2B30-5.01 (June, 1975), Application for Extension of Time to File Inheritance Tax Return and/or Pay Inheritance Tax. This extension request form is based upon the federal form²⁴ and allows the representative of the decedent's estate, the estate's attorney, or the estate's accountant to sign the form. Coupled with this is a new internal procedure adopted by the comptroller's office to allow qualifying estates to enter into a payout

23. The prior method for closing small estates is set forth in Comptroller's Ruling No. 30-0.10, 1 CCH [TEXAS] INH. EST. & GIFT TAX REP. ¶ 2205 (1972), which provides in part:

In the closing of an estate which is not of sufficient value to be taxable, the Comptroller will accept a copy of the inventory and appraisement and a copy of the last will and testament, and if there be no will, an affidavit of heirship. When no administration is necessary and/or the will is filed as a muniment of title only, an affidavit can be submitted to the Comptroller giving a complete description and value of the assets of the estate along with the names and relationship of the beneficiaries of the estate.

24. The federal form is the Application for Extension of Time to File U.S. Estate Tax Return and/or Pay Estate Tax (Form 4768, Apr. 1973), which was designed for extension requests under INT. REV. CODE OF 1954, §§ 6081, 6161.

agreement of up to ten years to pay the Texas inheritance tax. This procedure was adopted in response to problems faced by estates largely comprised of farm and ranch lands, which formerly were forced to make sales of this property in order to pay the Texas inheritance tax.²⁵

The promulgation of Form 2B30-25.50, Inheritance Tax Waiver, presents a new facet in obtaining inheritance tax waivers for the transfer of corporate stock. Previously, these "waivers," which release the state's lien on property, were automatically given with very little regard to whether any property would be left in the estate to assure that the inheritance tax could be collected. The new form requires appropriate information necessary to determine whether a release of the lien should be given.

Another form which soon will be in use is an inheritance tax receipt, which is to be filed with the probate court in which a resident decedent's estate is being administered. The new receipt will show not only that the inheritance taxes have been paid, but also that the amount paid is a final settlement of the estate and that all liens are released.²⁶

Finally, a system is being developed to identify delinquent accounts. Never before has there been a regular follow-up program on estates which have not fully reported to the state and those which have been billed but have never paid the amount determined to be due. County clerks now report an estate when the application for probate is filed. The comptroller's files are set up with this report and after nine months, if no return has been filed, the division will take appropriate action. The possibility of automating this system to assist in immediately identifying these delinquencies is presently being explored.

Inheritance Tax Reform. The Texas inheritance tax statute was largely rewritten in 1965 but has been amended very little since that time. Recently, a committee of probate judges chaired by Judge Jerome Jones of Galveston was formed to work with the inheritance tax division in developing changes in the inheritance tax law to aid both probate judges and the division.

It has also been suggested that Texas change from an inheritance tax system to an estate tax system. The states which have moved to an estate tax have done so because of the ease of administration inherent in that system of taxation. With an estate tax it is possible to avoid many of the distribution problems which give an inheritance tax its difficult character. It has been estimated that over sixty-five percent of the administrative and legal problems arising in the Texas inheritance tax division are the result of

25. Extension of time to pay the federal estate tax is also available. This includes INT. REV. CODE OF 1954, § 6161(a)(2) (undue hardship), § 6163 (estate tax attributable to remainder or reversionary interest), and § 6166 (where estate consists largely of interests in closely held business). Some recent revenue rulings discuss when real estate holdings can qualify as a "closely held business." See Rev. Rul. 75-367, 1975 INT. REV. BULL. No. 34, at 26; Rev. Rul. 75-366, 1975 INT. REV. BULL. No. 34, at 25; Rev. Rul. 75-365, 1975 INT. REV. BULL. No. 34, at 24.

26. For a discussion of some of the problems surrounding a determination of whether an inheritance tax "receipt" is a "release" see Tracy, *Taxation, Annual Survey of Texas Law*, 28 Sw. L.J. 340, 342-43 (1974).

the questions surrounding the methods of distributing property.²⁷ However, the feasibility of moving to an estate tax would necessarily include a study of a possible gift tax. The division staff believes that there are many lifetime transfers which are made in contemplation of death, but which now escape taxation because of the existing inheritance tax structure. With a combination gift and inheritance or estate tax, the transfers would not escape taxation.

The inheritance tax division and the comptroller's office are presently gathering information from other states to determine what administrative problems might arise in a conversion to an estate tax system should such legislation be enacted. Four states being studied which have changed from an inheritance to an estate tax are Ohio, which changed in 1967, North Dakota, which changed in 1975, South Carolina, which changed in 1961, and Mississippi, which changed in 1956.

C. *Miscellaneous Inheritance Tax Matters*²⁸

A recent decision in the hearings division of the comptroller's office²⁹ concerned whether credit life insurance qualifies for the \$40,000.00 life insurance exemption.³⁰ Although not specifically so stated in the facts, apparently there was no argument concerning the inclusion of the proceeds of the policy in the decedent's gross estate, nor the deductibility of the debt which the credit life insurance secured. Further, it appears that the credit life policy was issued to the creditor, as owner, with the proceeds payable to the creditor up to the amount of the debt, and the balance, if any, payable to a beneficiary designated by the debtor or the debtor's estate.³¹

Since the insurance proceeds were not payable directly to the executor of the decedent's estate, the comptroller relied upon the theory that they were nevertheless payable for the benefit of the executor, and thus receivable by him.³² In reaching this conclusion, the hearings examiner relied upon

27. Letter from Karen Johnson, Director of the Inheritance Tax Division of the Comptroller's Office, to J. David Tracy, Nov. 28, 1975.

28. The recent case of *Calvert v. Hall*, 514 S.W.2d 778 (Tex. Civ. App.—Austin 1974, writ dismissed), emphasizes the importance of proceeding under the correct statute in bringing an action against the comptroller. The representative of the decedent's estate brought suit in Hays County under the authority of TEX. TAX.-GEN. ANN. art. 14.11 (C)(4) (1969), which authorizes appeals from valuations placed on property by the comptroller for inheritance tax purposes. However, from the pleadings it was clear that the estate was actually contesting the right of the comptroller to levy the inheritance tax in the first instance. Thus, in accordance with *id.* art. 1.05, the court of civil appeals remanded the case with instructions that it be transferred to Travis County.

29. Comptroller's Dec. No. H-6748 (1975).

30. TEX. TAX.-GEN. ANN. art. 14.01(A)(2) (Supp. 1975-76) provides that the proceeds of life insurance are includable in a decedent's gross estate

to the extent of the amount receivable by the executor or administrator as insurance under policies taken out by the decedent upon his own life, and to the extent of the excess over Forty Thousand (\$40,000) Dollars of the amount receivable by all other beneficiaries as insurance under policies taken out by the decedent upon his own life.

For a general introduction into the taxability of life insurance under the Texas inheritance tax statutes see Kendrick, *Texas Death Taxes and Estate Planning*, 16 SW. L.J. 565, 571-74 (1962).

31. See generally 32 TEX. JUR. 2D Insurance § 110 (1962).

32. Comptroller's Ruling No. 30-0.05, 1 CCH [TEXAS] INH. EST. & GIFT TAX REP. ¶ 1580 (1973), provides that the insurance not subject to the \$40,000.00 exemption is that "payable directly or indirectly to the estate." (Emphasis added.)

To illustrate the effect of the comptroller's calculation, assume that a \$100,000.00 face

Treasury Regulations promulgated under section 2042 of the Internal Revenue Code, which provide, in part:

Section 2042 requires the inclusion in the gross estate of the proceeds of insurance on the decedent's life receivable by the executor or administrator, or payable to the decedent's estate. It makes no difference whether or not the estate is specifically named as the beneficiary under the terms of the policy. . . . [I]f the decedent purchased an insurance policy in favor of another person or a corporation as collateral security for a loan or other accommodation, its proceeds are considered to be receivable for the benefit of the estate. The amount of the loan outstanding at the date of the decedent's death, with interest accrued to that date, will be deductible in determining the taxable estate.³³

This has been the long-standing departmental construction of the statute by the comptroller's office, and although supported by the cases construing a similar statute in calculating the federal estate tax prior to 1942,³⁴ several factors militate against its acceptance.

First, in a situation where a decedent and his wife had assigned a community life insurance policy as collateral for a loan, the Texas Attorney General has ruled that one-half of the proceeds were includable in the decedent's estate against which the \$40,000.00 exemption was applied, and one-half of the community debt was also deductible.³⁵ It is submitted that

amount community life insurance policy is issued as collateral for an \$80,000.00 community debt, and that the \$40,000.00 life insurance exemption is totally applied to other life insurance policies. The calculation of the decedent's gross estate would be:

Schedule D (Life Insurance)	
Proceeds	\$50,000.00
Less: Exemption	(0.00)*
Total	\$50,000.00
Schedule K (Debts)	(40,000.00)
Net Gain	<u>\$10,000.00</u>

* Of course, the \$40,000.00 is actually allocated to the various beneficiaries on the basis of the life insurance proceeds receivable by each beneficiary. Comptroller's Ruling No. 30-0.05, 1 CCH [TEXAS] INH. EST. & GIFT TAX REP. ¶ 1580 (1973).

33. Treas. Reg. § 20.2042-1(b)(1) (1958).

34. See 2 J. MERTENS, LAW OF FEDERAL GIFT & ESTATE TAXATION § 17.07 (1959). However, any proceeds in excess of the debt were available for the \$40,000.00 exemption under these early federal statutes.

35. TEX. ATT'Y GEN. OP. NO. S-108 (1953). Assuming the same facts as in note 32 *supra*, the effect on the estate under the reasoning of this opinion would be:

Schedule D (Life Insurance)	
Proceeds	\$50,000.00
Less: Exemption	(40,000.00)
Total	\$10,000.00
Schedule K (Debts)	(40,000.00)
Net Deduction	<u>(\$30,000.00)</u>

The attorney general in reaching this conclusion stated that the indebtedness constituted a valid claim against the estate and not merely the life insurance proceeds, as would apparently be the case with a policy loan. Thus, the comptroller might be able to argue that due to the special character of credit life insurance, the correct calculation would be:

there is no difference, in legal effect, in this situation and one in which credit life insurance is purchased by a financial institution, so long as the credit life insurance proceeds are includable in the decedent's gross estate.

Second, the logical extension of the comptroller's decision is that any portion of life insurance proceeds receivable by a beneficiary and from which the executor requires contribution for its portion of the federal estate tax under section 2206 of the Internal Revenue Code³⁶ would not be available for the exemption. Further, if the decedent's will provided that all taxes, debts, and expenses were to be apportioned among the beneficiaries of the estate in proportion to the property received by each, then supposedly, the amount apportioned to life insurance would not be available for the \$40,000.00 exemption. In the author's opinion, it is questionable whether any of these views would be upheld by the courts.

Finally, the federal regulations relied upon by the hearings examiner are concerned only with the inclusion of life insurance proceeds in order to calculate an estate tax, rather than an inheritance tax. Also, since these regulations are designed, in part, to remedy a flaw in the definition of an "executor" under section 2203 of the Internal Revenue Code, they should not be used as a basis for determining whether insurance proceeds are receivable by the executor under the Texas inheritance tax statutes.³⁷

II. FRANCHISE TAXES

A. Legislative Changes

Rate of Tax. Article 12.01³⁸ has been completely restated to provide for a franchise tax on domestic or foreign corporations doing business in Texas at the greater of \$4.25 per \$1,000.00 of the corporation's taxable capital, \$4.25 per \$1,000.00 of assessed value for ad valorem tax purposes of the corporation's real or personal property situated in Texas, or \$55.00. This consolidates the old articles 12.01 and 12.211, which together had provided the same \$4.25 figure with a minimum tax of \$54.09 rather than \$55.00.³⁹

Schedule D (Life Insurance)	\$50,000.00	
Less: Indebtedness	(40,000.00)	
Subtotal	10,000.00	
Less: Exemption	(40,000.00)	
Total		\$0.00
Schedule K (Debts)		0.00
Net		<u>\$0.00</u>

36. INT. REV. CODE OF 1954, § 2206.

37. *Id.* § 2203; see R. STEPHENS, G. MAXFIELD & S. LIND, *supra* note 9, at 4-215 to -216.

38. TEX. TAX-GEN. ANN. art. 12.01 (Supp. 1975-76). The new act consolidated the provisions relating to the taxation of public utilities contained in *id.* arts. 12.01(2)-(4) (1969), and eliminated a special provision for corporations which had not adopted the Texas Business Corporation Act in *id.* art. 12.01(5).

39. The prior statutes produced the \$4.25 figure by combining a basic franchise tax of \$2.75 per \$1,000.00 of taxable capital or assessed valuation of property for ad valorem tax purposes, with an additional franchise tax of 54.54% of the basic tax, or \$1.50 for each \$2.75, to yield \$4.25.

Although not strictly concerned with the rate of franchise taxes, new article 12.06(3)⁴⁰ liberalizes, to some extent, the deposit required by foreign corporations. A foreign corporation must still deposit \$500.00 with the comptroller to insure compliance with the franchise tax statutes. However, if the corporation has maintained its good standing for three years in complying with the franchise tax statutes or is determined to be exempt, the comptroller is to return the corporation's deposit.⁴¹ If the foreign corporation subsequently fails to comply with the Texas franchise tax statutes or loses its exemption, then the \$500.00 deposit is to be reinstated.

Taxable Capital. The Texas franchise tax is levied upon a corporation's taxable capital, which includes stated capital, surplus, and undivided profits.⁴² New article 12.01(6)⁴³ allows a corporation to deduct from its taxable capital, ratably over a period of not less than sixty months after it has been put in service, the cost of a solar energy device which is used by the corporation for the production of heating and cooling.⁴⁴ It is clear from the statutory language that to be deductible, the solar energy unit *must* be used in the State of Texas. This creates at least two problems of construction. First, it is not clear from the statute what portion of the cost of a solar energy

40. TEX. TAX.-GEN. ANN. art. 12.06(3) (Supp. 1975-76).

41. *Id.* art. 12.06(3) provides in part (emphasis added):

Upon determination by the comptroller that a foreign corporation has maintained a continuous status in good standing for three (3) consecutive reporting years, or *upon determination by the comptroller* that a corporation is exempt from payment of the franchise tax under Article 12.03 of this chapter or other laws of this state, *such corporation shall be exempt* thereafter from the security requirements of this article, and the *comptroller shall* return the trust deposit to the corporation; provided, however, that such exemption from the security requirement shall continue only until such time that *it is determined by the comptroller* that the corporation has failed to file all reports or to pay the franchise tax or other payments required by this chapter, or that the corporation no longer qualifies for exemption from the franchise tax

Considering the requirements of the franchise tax statutes, the comptroller's determinations apparently are to be objective in nature rather than discretionary.

42. Stated capital is basically the par value or actual consideration received for a corporation's stock, Comptroller's Ruling No. 80-0.08, P-H STATE & LOCAL TAXES ¶ 15,721 (1966), while surplus and undivided profits include all surplus items which are defined in TEX. BUS. CORP. ACT ANN. art. 1.02(12) (1956). Comptroller's Ruling No. 80-0.09, P-H STATE & LOCAL TAXES ¶ 15,723 (1966).

A recent decision in the hearings division of the comptroller's office, Comptroller's Dec. No. H-6492 (1975), held that an oil production payment is an indebtedness of the owner of the mineral property, there the corporate taxpayer. As oil is produced from the property, the owner recognizes income and his outstanding liability for the production payment is correspondingly reduced. In holding that an oil production payment is not a part of the corporation's surplus, the hearings examiner recognized that the present effect of Comptroller's Ruling No. 80-0.12, P-H STATE & LOCAL TAXES ¶ 15,732 (1966), is only to characterize such payments as debts. The remaining portion of that ruling dealing with the effect of oil production payments made within one year as opposed to a longer period is not relevant to the present franchise tax statutes, as there is no longer any tax levied upon a corporation's debt. See TEX. TAX.-GEN. ANN. art. 12.01(1)(a)(ii) (1969), which expired April 30, 1973.

43. TEX. TAX.-GEN. ANN. art. 12.01(6) (Supp. 1975-76). The statute contains a drafting error in designating this new provision subparagraph "(6)," since the prior five subparagraphs were consolidated into only two subparagraphs by this same legislation.

44. In order to obtain the benefit of this provision: "A corporation making a deduction under this Section shall file with the Comptroller an amortization schedule showing the period during which a deduction is to be made and upon the request of the Comptroller shall provide proof of the cost of the device and of its operation in this State." *Id.*

unit, if any, would be entitled to special amortization treatment if it were first used in some other state and then brought into Texas.⁴⁵ Second, it would seem that the legislature's attempt to limit a deduction for such devices to only those units actually used in the State of Texas is futile. The definition of "surplus," as used in the franchise tax statutes, is based upon the Texas Business Corporation Act definition as "the excess of the net assets of the corporation over its stated capital."⁴⁶ Under this definition, reserve accounts,⁴⁷ depreciation,⁴⁸ and cost depletion⁴⁹ have been allowed as deductions in computing a corporation's taxable capital. In the author's opinion, a similar deduction should be available for solar energy devices wherever situated, although the amortization schedules for such devices may not coincide with the five-year schedule set forth in the new statute.

Exempt Corporations. Article 12.03 setting forth exemptions from the Texas franchise tax has been restructured to allow easier determination of whether a corporation qualifies for an exemption.⁵⁰ With a few exceptions, the same basic exemptions are provided as were available prior to this amendment.⁵¹ New specific exemptions are available for corporations exempt under other laws of the state,⁵² corporations exempt under certain

45. The statute does provide, however, that once placed in service in the state of Texas, the cost of the solar energy unit can only be amortized over the actual period of time it is used in this state. *Id.*

46. TEX. BUS. CORP. ACT ANN. art. 1.02(12) (1956); Comptroller's Ruling No. 80-0.08, P-H STATE & LOCAL TAXES ¶ 15,721 (1966).

47. Huey & Philp Hardware Co. v. Shepperd, 151 Tex. 462, 251 S.W.2d 515 (1952) (reserves for bad debts); Calvert v. Houston Lighting & Power Co., 369 S.W.2d 502 (Tex. Civ. App.—Austin 1963, writ ref'd n.r.e.) (reserves for deferred federal income taxes which will be payable in future years due to accelerated methods of depreciation, as opposed to straight line depreciation being currently taken). *See also* TEX. ATT'Y GEN. OP. No. H-62 (1973). *But see id.* No. S-217 (1956) (reserves for vacation pay to be paid to employees in future years is part of corporate surplus); Comptroller's Ruling No. 80-0.13, P-H STATE & LOCAL TAXES ¶ 15,735 (1966) (intangible development costs which are capitalized on the corporate books, even though treated as an expense for federal income tax purposes are a part of surplus).

48. *See* Calvert v. Houston Lighting & Power Co., 369 S.W.2d 502 (Tex. Civ. App.—Austin 1963, writ ref'd n.r.e.); Comptroller's Ruling No. 80-0.09, P-H STATE & LOCAL TAXES ¶ 15,723 (1966).

49. Comptroller's Ruling No. 80-0.14, P-H STATE & LOCAL TAXES ¶ 15,738 (1966).

50. TEX. TAX-GEN. ANN. art. 12.03 (Supp. 1975-76). Under the new statutory format, the exempt corporations are listed in outline rather than paragraph form.

51. These exceptions include: (a) the deletion of the no capital stock requirement and the inclusion of a nonprofit requirement for corporations organized for the exclusive purpose of promoting the public interest of a county, city or town; (b) the removal of a no capital stock requirement for corporations engaged in educating the public on conservation matters; (c) the inclusion of a nonprofit requirement for corporations holding agriculture fairs; (d) the consolidation of exemption requirements for convalescent homes or housing for the disabled, whether or not the organization is a purely public charity; and (e) codification of Comptroller's Ruling No. 80-0.15, P-H STATE & LOCAL TAXES ¶ 15,726 (1973), and Calvert v. Capital Sw. Corp., 441 S.W.2d 247 (Tex. Civ. App.—Austin, writ ref'd n.r.e.), *appeal dismissed*, 397 U.S. 321 (1969), providing that only an "open-end investment company" qualifying under the Investment Company Act of 1940 qualifies for a franchise tax exemption, with the further new requirement that this must also be a registered investment company under the Texas Securities Act.

52. TEX. TAX-GEN. ANN. art. 12.03(1)(p) (Supp. 1975-76). For example, under TEX. REV. CIV. STAT. ANN. art. 342-908 (1973) of the Texas Banking Code, a state bank is liable for only such taxes to which it would be subject as a national bank. This has been interpreted by the comptroller to mean that such banks are exempt from the Texas franchise tax. *See* 1 CCH TEX. STATE TAX REP. ¶ 5-203B (1975); *But see* Grayson County State Bank v. Calvert, 357 S.W.2d 160 (Tex. Civ. App.—Austin 1962,

provisions of the Internal Revenue Code of 1954,⁵³ and corporations engaged *exclusively* in the business of manufacturing, selling, and installing solar energy devices used in the production of heating and cooling.⁵⁴

New procedural steps have been added to the exemption provisions. If the corporation's application for exemption is submitted within the later of fifteen months from the date of its charter or September 1, 1975, the exemption if granted will be effective as of the date of the corporation's charter.⁵⁵ A corporation seeking a federal income tax exemption, which would also afford it a franchise tax exemption, can submit evidence to the comptroller of its good faith filing attempt. If this is done, then a subsequent denial of the federal exemption will not cause the corporation to be subjected to any penalties for failure to pay franchise taxes from the date of the corporation's charter to the date of the denial.⁵⁶ The new statute also clarifies the effect of a corporation's loss of its exempt status under the franchise tax statutes by providing that the franchise tax exemption terminates on the April 30th following the withdrawal of its federal tax exemption.⁵⁷

If a corporation were granted a franchise tax exemption prior to September 1, 1975, it would not be required to make any additional filings in order to retain its exempt status.⁵⁸ Apparently superseding this general provision, however, is a specific provision prescribing that any corporation organized for "strictly educational" purposes must file within the later of fifteen months from the date of its charter or fifteen months from September 1, 1975, "sufficient evidence" that it is exempt from the federal income tax. This requirement can be satisfied by filing a copy of the determination letter from the Internal Revenue Service establishing its exempt status or evidence of a good faith filing for that exemption.⁵⁹

writ ref'd n.r.e.) (decided prior to 1963 amendment to Texas Banking Code). Of course, a state bank is subject to taxation under TEX. REV. CIV. STAT. ANN. art. 7166 (1960).

It should be noted that these new provisions do not purport to levy a franchise tax upon national banks under the authority of 12 U.S.C. § 548 (1970). Ch. 719, art. XII, § 5, [1975] Tex. Laws 2314. See Pub. L. No. 93-100, 87 Stat. 342 (1973); Hellerstein, *Current Issues in Multistate Taxation of Banks*, 30 TAX L. REV. 155 (1975).

53. TEX. TAX-GEN. ANN. art. 12.03(1)(q) (Supp. 1975-76). This includes those organizations exempt from the federal income tax under INT. REV. CODE OF 1954, §§ 501(c)(3)-(7), which can generally be described as "public" charities, civic leagues, employee organizations, labor or agricultural organizations, business leagues, chambers of commerce, and social clubs.

54. TEX. TAX-GEN. ANN. art. 12.03(1)(r) (Supp. 1975-76).

55. *Id.* art. 12.03(5).

56. *Id.* art. 12.03(3).

57. *Id.* art. 12.03(4). It should be noted that this provision is concerned specifically with the *loss* of the federal tax exemption and not with those corporations which qualify for the franchise tax exemption but do not qualify for a federal tax exemption. In the latter situation it is unclear whether the exempt status terminates immediately upon the corporation's failure to qualify for the exemption, or whether its exempt status would continue until the following April 30. Under *id.* art. 12.03(6) any such corporation granted a franchise tax exemption prior to September 1, 1975, but which no longer qualifies for the exemption, would remain exempt until April 30th following its failure to qualify.

58. *Id.* art. 12.03(6).

59. *Id.* art. 12.03(2).

B. *Allocation Formula*⁶⁰

As was true during the last survey period,⁶¹ the allocation formula used to determine the amount of franchise taxes due the State of Texas has again come under scrutiny by the courts. Under article 12.02⁶² a corporation doing business in Texas determines its franchise taxes on the basis of a formula using its total gross business receipts, both within and without the state.⁶³ In *Texaco v. Calvert*⁶⁴ the court was confronted with ascertaining when a corporation would be permitted to use an alternate allocation formula. In substance, article 12.02(2)⁶⁵ provides that a taxpayer may take into account other factors in determining its franchise tax if the standard allocation formula does not "fairly represent the extent of the taxpayer's business activity in Texas."⁶⁶

60. For an introduction into the use of allocation formulas see generally W. BEAMAN, *PAYING TAXES TO OTHER STATES* 15.1-.8 (1963).

Two recent United States Supreme Court cases have dealt with state franchise taxation of an interstate business. First, in *Colonial Pipeline Co. v. Triagle*, 421 U.S. 100 (1975), the Court upheld a "fairly apportioned and nondiscriminatory" franchise tax on an interstate pipeline common carrier, which had voluntarily qualified to do business in Louisiana. Secondly, in *Pressed Steel Co. v. Washington Revenue Dept.*, 419 U.S. 560 (1975), the Court upheld a Washington business and occupation tax which was levied on the total gross receipts of an interstate business from sales within the State of Washington.

61. See Tracy, *Taxation, Annual Survey of Texas Law*, 29 Sw. L.J. 326, 329-31 (1975).

62. TEX. TAX.-GEN. ANN. art. 12.02(1)(A) (1969) provides that a corporation calculates the Texas franchise tax by multiplying its taxable capital by the percentage "which the gross receipts from its business done in Texas bear to the total gross receipts of the corporation from its entire business." The allocation formula can be expressed as follows:

Franchise Tax	=	Taxable Capital	X	<table> <tr> <th>Texas Gross Receipts</th> </tr> <tr> <td>Entire Gross Receipts</td> </tr> </table>	Texas Gross Receipts	Entire Gross Receipts	X	Rate of Tax
Texas Gross Receipts								
Entire Gross Receipts								

For the purposes of the allocation formula, taxable capital includes the corporation's stated capital, surplus and undivided profits wherever located. *Ford Motor Co. v. Beauchamp*, 308 U.S. 331 (1939). The Texas allocation formula is criticized in 5 Hous. L. REV. 132 (1967).

63. Two recent Texas Attorney General opinions were concerned with determining what constituted gross receipts from business done within Texas, *i.e.*, the numerator of the allocation formula. TEX. ATT'Y GEN. OP. No. H-710 (1975) held that, as a general premise, commissions of a stockbroker constitute receipts for services and, thus, should be allocated on the basis of the percentage of services performed in Texas. In the other opinion, *id.* No. H-640, the attorney general held that the gross receipts of a gas producer are attributable to business done within Texas when title to and possession of the gas passed to the purchaser (who thereafter had the risk of loss) at the well head or plant site, both of which were in Texas. The fact that the gas might then be transported outside of Texas as part of a subsequent sale would have a bearing on the franchise taxation of the pipeline company, but not the gas producer.

64. 526 S.W.2d 630 (Tex. Civ. App.—Austin 1975, writ ref'd n.r.e.).

65. TEX. TAX.-GEN. ANN. art. 12.02(2) (1969) provides that:

[T]he taxpayer may petition for and the Comptroller may permit, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) separate accounting;
 (b) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in Texas; or
 (c) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's capital.

66. *Id.*

Texaco had domestic gross receipts from the sales of oil, gas, and other petroleum products, but its only receipts from subsidiary corporations or affiliated companies, wherever located, were dividends and interest.⁶⁷ In an effort to reduce its corporate franchise taxes, Texaco had presented several alternate allocation formulas to the comptroller,⁶⁸ but both the comptroller and the court of civil appeals denied Texaco's right to use any of the proposed allocation formulas.

Although the court of civil appeals mentioned that Texaco chose the form in which it would transact its business and that form had certain ramifications on the Texas franchise tax, in the author's opinion, the importance of the opinion is the following statement of the requisites needed to obtain the benefit of the alternate formula:

Before the Comptroller is called upon to consider alternative allocation formulae, pursuant to the terms of Art. 12.02(2), the taxpayer has the burden to demonstrate that the allocation and apportionment provisions of Section (1) do not fairly represent the extent of the taxpayer's business activity in Texas. If the taxpayer successfully discharges that burden, then the Comptroller *may* permit other allocation methods *if* reasonable. The Comptroller is not required to grant the taxpayer relief simply because alternative formulae, which produce a lesser tax, are proposed. The Comptroller's grant of relief to the taxpayer is permissive and is predicated upon a showing that the proposed alternate formulae are reasonable.⁶⁹

67. Since the dividends and interest received by Texaco from its subsidiaries and affiliated companies are net figures after allowances for cost of goods sold and operating and administrative expenses, these items would be substantially smaller than the gross receipts from the business from which the dividends and interest were derived. Thus, the inclusion of the dividends and interest in the denominator of the allocation formula, rather than the gross receipts of the business from which the dividends and interest were derived, produces a larger percentage of Texaco's taxable capital subject to the Texas franchise tax. Most likely, many of Texaco's subsidiaries and affiliated companies were not Texas corporations, so that the dividends and interest received from these corporations would not be includable in Texaco's gross receipts from business within Texas. See Comptroller's Ruling No. 80-0.18, P-H STATE & LOCAL TAXES ¶ 15,745 (1975); Humble Oil & Ref. Co. v. Calvert, 414 S.W.2d 172 (Tex. 1967).

68. The court stated Texaco's proposed formulas to be as follows:

As we understand, appellant's alternative allocation formula would involve a separate accounting whereby those assets representing investment capital employed or controlled and managed outside of Texas would be deducted from taxable capital prior to the computation of the franchise tax. The capital remaining would be apportioned under Art. 12.02(1). Another method proposed by appellant was permission to file on a consolidated basis wherein the gross receipts of appellant's subsidiaries and affiliates would be included in the gross receipts of appellant and that the allocation percentage thus attained would be applied against the entire combined capital of appellant and its subsidiaries and affiliates. One more alternative method pressed by appellant was the use of 'constructive gross receipts.' Under that method the gross receipts which give rise to dividends would be reconstructed or as a witness said 'estimated' and would be included with other gross receipts of appellant for the purpose of allocation under Art. 12.02(1).

526 S.W.2d at 632-33.

69. *Id.* at 634 (emphasis in original). See generally Lane, *Recent Changes in Texas Franchise Tax Law*, 5 STATE BAR OF TEXAS, NEWSLETTER OF THE SECTION OF TAXATION, No. 2, July 1972, at 6-8.

The comptroller has established a "three-factor" alternate formula to be used under TEX. TAX-GEN. ANN. art. 12.02(2) (1969). Comptroller's Ruling No. 80-0.17, P-H STATE & LOCAL TAXES ¶ 15,744 (1973). In fact, the procedural requirements of this ruling must be stringently adhered to in order for a corporation to be eligible to apply for alternate treatment under the statute. Comptroller's Dec. No. H-6419 (1975).

C. *Miscellaneous Franchise Tax Matters*⁷⁰

The Texas Supreme Court in *Calvert v. Texas Pipeline Co.*⁷¹ construed that portion of article 12.20 imposing an additional franchise tax for those corporations paying a franchise tax "under the provisions of this Chapter for the preceding fiscal year as shown in the report . . . filed . . . between January 1 and May 1, 1971 (or the initial or first year report required to be filed . . .)." ⁷² The legislature in drafting the statute apparently overlooked the 1969 amendment to article 12.08 which changed the period during which a corporation must file a franchise tax return from "between January 1st and May 1st" to "between January 1st and June 15th." ⁷³

As predicted in the last *Survey*,⁷⁴ the supreme court overruled the court of civil appeals and agreed with the comptroller that all "regular" corporations (*i.e.*, corporations other than first year corporations) were subject to the additional franchise tax. In the author's opinion the court reached the correct conclusion, although one portion of the decision could prove to be troubling as a precedent for statutory construction. This stems from the court's reliance for its decision upon that portion of article 12.20 providing that the franchise tax is levied upon "all corporations paying a franchise tax under the provisions of this Chapter for the preceding fiscal year as shown in the report required to be filed with the Comptroller of Public Accounts . . . under the provisions of this Chapter . . ." ⁷⁵

Thus, in the court's view, if the legislature had merely referred to corporations filing franchise tax reports between January 1 and May 1, its decision would have been different.⁷⁶ Considering the loss of revenue to the state if the comptroller's view of the statute were not upheld and also the other arguments available to the court in upholding the statute, it is doubtful that such a case would have been decided any differently by the court.⁷⁷

III. SALES AND USE TAXES⁷⁸

A. *Limited Sales, Excise and Use Tax Act*

Despite considerable activity,⁷⁹ there were few items of significance in the

70. In *Universal Underwriter's Ins. Co. v. McBeth*, 526 S.W.2d 715 (Tex. Civ. App. —Waco 1975, writ ref'd n.r.e.), the court emphasized that in order to attach personal liability to the officers and directors of a corporation for debts contracted after the corporation has forfeited its right to do business in Texas under TEX. TAX-GEN. ANN. art. 12.14 (1969), the officers and directors must have had knowledge of, consented to, and approved the debts. For a recent case discussing the enforcement of a Texas judgment rendered under this statute in a sister state pursuant to the full faith and credit clause see *Overmyer v. Eliot Realty*, 371 N.Y.S.2d 246 (Sup. Ct. 1975).

71. 517 S.W.2d 777 (Tex. 1975).

72. TEX. TAX-GEN. ANN. art. 12.20(1) (Supp. 1975-76) which expired April 30, 1972. Compare *id.* art. 12.211 [Ch. 292, art. III, § 2, [1971] Tex. Laws 1199] imposing an additional franchise tax after May 1, 1972, which makes no reference to when the franchise tax return is filed. The latter provision was repealed effective September 1, 1975. Ch. 719, art. XII, § 4, [1975] Tex. Laws 2314.

73. TEX. TAX-GEN. ANN. art. 12.08(1) (1969).

74. Tracy, *supra* note 61, at 332.

75. TEX. TAX-GEN. ANN. art. 12.20(1) (Supp. 1975-76).

76. 517 S.W.2d 777, 780-81 (Tex. 1975).

77. See, e.g., Lane, *supra* note 69, at 5-6; Tracy, *supra* note 61, at 332.

78. There were two United States Supreme Court decisions dealing with sales and

limited sales, excise and use tax area.⁸⁰ There was a flurry of legislative changes,⁸¹ the majority of which concerned exemptions.⁸² The cases and departmental decisions dealt with such varied topics as the taxability of processing key punch cards⁸³ and computer use time,⁸⁴ food served to

use taxes during the survey period. In *United States v. State Tax Comm'n*, 421 U.S. 599 (1975), the Court held that a "wholesale markup" imposed by the Mississippi tax commission on a military club's purchases from out-of-state liquor distillers was a sales tax. Since the legal incidence of this tax fell upon an instrumentality of the United States (*i.e.*, the military-purchaser), the tax was unconstitutional. The second case, *Gurley v. Rhoden*, 421 U.S. 200 (1975), held that a 5% Mississippi sales tax imposed upon the gross proceeds from the retail sale of gasoline was constitutional, even though no deduction was allowed for Mississippi or federal excise taxes on the gasoline.

79. Comptroller's Dec. No. H-6759 (1975) was the only decision concerned with the Local Sales and Use Tax Act. In this case the hearings examiner held that pipe purchased in Europe and shipped to Houston was a "sale" under the Act, even though exempt from use taxes by TEX. TAX-GEN. ANN. art. 20.04(G)(3)(a) (1969), since all incidents of the sale (including delivery of the pipe and payments therefor) took place in Texas. See TEX. REV. CIV. STAT. ANN. art. 1066c, § 6B(1) (Supp. 1975-76).

The only legislative change was TEX. REV. CIV. STAT. ANN. art. 1066c, §§ 12A, 12C (Supp. 1975-76), allowing cities in certain circumstances to bring suit for the collection of delinquent city sales, excise, and use taxes.

80. In *Day & Zimmerman, Inc. v. Calvert*, 519 S.W.2d 106 (Tex. 1975), the Supreme Court of Texas was confronted with a taxpayer who was responsible for the loading, assembling, and packaging of ammunition and related matters under a "cost-plus" contract with the Government. The court found that although the taxpayer was not an agent of the federal government (thus being entitled to an exemption under TEX. TAX-GEN. ANN. art. 20.04(H) (1969)), it was still not liable for any sales taxes. First, the goods purchased by the taxpayer from third party vendors were for "resale," thus exempting this transaction. TEX. TAX-GEN. ANN. art. 20.04(O) (1969); see Comptroller's Ruling No. 95-0.05, P-H STATE & LOCAL TAXES ¶ 21,508 (1974). Second, the sale of these goods from the taxpayer to the military was exempt as a sale to a governmental agency. TEX. TAX-GEN. ANN. art. 20.04(H) (1969); Comptroller's Ruling No. 95-0.35, 1 CCH TEX. STATE TAX. REP. ¶ 60-236 (1972). See generally Tracy, *supra* note 61, at 333-34.

81. An interesting legislative drafting error has occurred in the definition of "sales price." TEX. TAX-GEN. ANN. art. 20.01(L)(3)(h) (Supp. 1975-76) was added by ch. 108, § 1, [1975] Tex. Laws 262, and excludes "voluntary gratuities" from the definition of "sales price." This was passed by the House on March 24, 1975, and the Senate on April 17, 1975, effective April 30, 1975. Subsequently, TEX. TAX-GEN. ANN. arts. 20.01(L)(3)(c), (h) (Supp. 1975-76), were amended by ch. 719, art. VIII, § 1, [1975] Tex. Laws 2307, to exclude from the definition of "sales price" certain federal excise taxes and the face value of United States coin or currency in a transaction where the total consideration exceeds such face amount. This latter act was passed by the house on May 23, 1975, and after senate amendments, became effective September 1, 1975. Taking these enactments at face value, it would seem that the exclusion of voluntary gratuities from the definition of "sales price" was a part of the Texas statutes only from May 1, 1975, to August 31, 1975. It is submitted, however, that this was not the intent of the legislature, and that the courts, if confronted with this problem, would carry out the legislative intent by renumbering the statute.

82. TEX. TAX-GEN. ANN. art. 20.04(BB) (Supp. 1975-76) (exempting certain component parts used in the production of a newspaper); *id.* art. 20.04(CC) (exempting receipts from the sale, rental, etc., of solar energy devices); *id.* art. 20.04(DD) (exempting certain athletic organizations from the sales tax); *id.* art. 20.04(EE) (the "Camp Fire Girl" exemption for proceeds of certain fund-raising drives); *id.* art. 20.04(F) (exempting receipts from certain functions conducted by a parent-teacher association); *id.* art. 20.04(H)(6) (exempting nonprofit organizations engaged in the bicentennial celebration from sales tax on certain items until June 1, 1978); *id.* art. 20.04(N)(6) (exempting certain agricultural machinery and equipment); *id.* art. 20.04(P)(1) (concerning the exemption from the sales tax for materials which become component parts of certain vessels, and the receipts from the sale of certain vessels); and *id.* art. 20.04(Q) (exempting certain aircraft from the sales and use tax).

83. When information is punched onto a card for computer use, this constitutes the processing or imprinting of tangible personal property as defined in *id.* art. 20.01(K)(2)(a) (1969) and is thus subject to sales tax. Comptroller's Dec. No. H-6087 (1975).

84. Comptroller's Dec. No. H-5457 (1975) held that the sale or lease of computer

employees,⁸⁵ and gas or electricity used in freezing meat,⁸⁶ among others.⁸⁷ *Constitutionality of Act. American Transfer & Storage Co. v. Bullock*⁸⁸ laid to rest the question of the legislature's authority under the Texas Constitution to impose a sales and use tax on the populace. This is a significant decision, as the courts have not squarely faced this constitutional question before.⁸⁹ The Texas Constitution, in article VIII, section 1, provides in part: "Taxation shall be equal and uniform. All property in this State, . . . other than municipal, shall be taxed in proportion to its value The Legislature may impose a poll tax . . . occupation taxes, . . . [and] . . . [it] may also tax incomes of both natural persons and corporations other than municipal"⁹⁰ And in section 17 of the same article it provides that "The specification of the objects and subjects of taxation shall not deprive the Legislature of the power to require other subjects or objects to be taxed in such manner as may be consistent with the principles of taxation fixed in this Constitution."⁹¹

time through the use of a terminal is a nontaxable service, if separately billed to the customer. However, the sales tax is applicable to any charges for computer machines and equipment, such as charges for the computer terminal. *Compare id.* No. H-6755 (purchase of computer programs is subject to sales tax).

85. *Compare id.* No. H-6755 (payments to third party by taxpayer representing "costs" plus management fee for serving food, without charge, to officers and employees of taxpayer and limited number of other persons is subject to sales tax), *with id.* No. H-6451 (where no specific charge is made by taxpayer for meals furnished to employees, no sales tax is due). *See also* TEX. ATT'Y GEN. OP. No. H-639 (1975) (jail commissaries must collect state, and if applicable, city sales tax on all items sold, except for food, soft drinks, and candy).

86. Comptroller's Dec. No. H-5744 (1975) held that the freezing or chilling of produce, meats, and similar items constitutes "processing," so that the gas and electricity used in this process is exempt from the sales tax under TEX. TAX.-GEN. ANN. art. 20.04(R) (1969). However, the power used in the storage of such goods after they have been frozen or chilled is not "processing" but is a "commercial use" thereof and, thus, subject to the sales tax.

87. *First Nat'l Bank v. Whirlpool Corp.*, 517 S.W.2d 262 (Tex. 1975) (the statutory materialman's lien includes sales taxes upon appliances furnished by a supplier); TEX. ATT'Y GEN. OP. No. H-470 (1974) (aircraft sold to a person holding an air-taxi certificate is exempt under TEX. TAX.-GEN. ANN. art. 20.04(Q) (1969), but the mere holding of a certificate of air worthiness, a certificate of registration, or a pilot's license would not qualify the purchaser, ipso facto, under this exemption); Comptroller's Dec. No. H-6928 (1975) (retail sales directly to the crews of foreign ships in the port of Houston do not qualify for an exemption under TEX. TAX.-GEN. ANN. art. 20.04(P)(2) (Supp. 1975-76) as materials or supplies sold to the owners or operators of vessels who, in turn, furnish these items to crew members while in interstate commerce); Comptroller's Dec. No. H-6533 (1975) (sale of operating assets of a franchise store in Oklahoma to a new franchisee in Texas is exempt from the sales tax under TEX. TAX.-GEN. ANN. arts. 20.01(F)(2), .04(I) (1969) as an occasional sale); Comptroller's Dec. No. H-6363 (1975) (The entire lump sum price for the sale and installation of shock absorbers is subject to sales tax under TEX. TAX.-GEN. ANN. arts. 20.01(D)(1)(b), and (L)(1)(b) (1969). The taxpayer was not a "repairman" under *id.* art. 20.01(T), so that the tax would be calculated only on the purchase price of the shock absorbers, since the taxpayer did "not make repairs to the shock absorbers. The old shock absorbers [were] merely replaced with new ones.").

88. 525 S.W.2d 918 (Tex. Civ. App.—Austin 1975, writ ref'd).

89. The constitutionality of the Limited Sales, Excise and Use Tax Act had not been previously litigated, although other peripheral constitutional issues had been raised. *See, e.g.,* Calvert v. Canteen Co., 371 S.W.2d 556 (Tex. 1963) (sales tax did not unconstitutionally discriminate against vending machine retailers who could not recoup sales tax from purchasers); TEX. ATT'Y GEN. OP. No. V-1155 (1951) (the adoption of the then proposed constitutional amendment to art. VIII, § 1, prohibiting the levy of a general sales tax would have no effect on existing statutes).

90. TEX. CONST. art. VIII, § 1.

91. *Id.* § 17.

The taxpayer argued that section 17 limited the legislature in its power of taxation by providing that no tax could contravene the principles of taxation set out in the Texas Constitution. Thus, since article VIII, section 1 governs the power of the legislature to levy taxes and since sales taxes are not enumerated among the permissible levies, the legislature did not have the power to enact the Limited Sales, Excise and Use Tax Act.⁹² Obviously, to reach this conclusion, the taxpayer must consider section 17 as *not* granting the legislature the general power to levy taxes. Consequently, only the four enumerated taxes mentioned in section 1 would be within the scope of the legislature's power to tax.

Contrary to the taxpayer's view, the court of civil appeals held that the legislature had the inherent plenary power to levy a sales and use tax.⁹³ To hold otherwise would mean that section 17 must be disregarded as being without purpose or meaning. That section clearly gives the legislature the power to tax subjects and objects other than those enumerated in section 1, so long as it does not contravene the principles of taxation set forth in the Texas Constitution. Clearly, the sales and use tax is not such a contravention.⁹⁴

*Procedural Matters.*⁹⁵ A recent decision in the hearings division of the

92. In the commentary on the provisions of § 17, Thomas, *Interpretive Commentary*, 2 TEX. CONST. 565 (1955), the following statement is made:

In the Texas Constitution, four types of taxes are designated as taxes the Legislature may levy: property taxes, poll taxes, occupation taxes, and income taxes (Art. 8, § 1). This enumeration has led to the legislature's labeling of many taxes as occupation taxes, even though they might not be ordinarily so considered.

Although Art. 8, § 17 would seem to indicate that any taxing power inherent in sovereign governments would of necessity also belong to the government of Texas unless specifically denied it by the constitution, the courts have avoided a clear cut decision as to whether or not the legislature has power to levy sales or excise taxes without being designated and intended as occupation taxes. Although recent years have indicated a wide acceptance of the opinion that the legislature has a general taxing power, the issue has not been finally settled, and the seemingly limiting provisions of Art. 8, § 1 rather than the broad grant of power given by this article still govern tax legislation.

See also Anderson, *Constitutional Aspects of Revenue and Taxation in Texas*, 35 TEXAS L. REV. 1011, 1013 (1957); 7 STATE BAR OF TEXAS, NEWSLETTER OF SECTION OF TAXATION, No. 1, Sept. 1973, at 12.

93. The court stated:

We hold that although the types of taxes imposed by the Limited Sales, Excise and Use Tax Act are not enumerated in section 1 of Article VIII of the Constitution, the Act is not by reason of such omission invalid and in violation of the Constitution. We hold that the Legislature has plenary power to require other subjects and objects to be taxed if that power is exercised in a manner consistent with the principles of taxation fixed in the Constitution.

525 S.W.2d at 923.

94. In two incidental matters, the court also held that exemptions granted for materials used in packaging and wrapping in connection with manufacturing did not yield unequal tax treatment for taxpayers engaged in service businesses who did not have such exemptions. Further, the Limited Sales, Excise and Use Tax Act did not violate the equal protection clause of the United States Constitution. *Id.* at 925-26.

95. Recently, the Texas Attorney General, in TEX. ATT'Y GEN. OP. NO. H-468 (1974), held that when an existing business is restructured (e.g., where a corporation merges or consolidates, a sole proprietorship or partnership incorporates, a sole proprietorship changes to a partnership, etc.), a new bond or other security is required under TEX. TAX.-GEN. ANN. art. 20.021(N)(2) (Supp. 1975-76). In each case the new entity

comptroller's office⁹⁶ emphasized the liability of the purchaser-consumer for the use tax. In the facts of that case, no sales tax was itemized on the invoice received by the taxpayer. From this the taxpayer argued that since the retailer is required by article 20.021 to collect the sales tax, which tax becomes "a part of the price" of the item,⁹⁷ it must be assumed that the retailer included these taxes in the figure shown on the invoice. Contrary to this argument, the hearings examiner held that absent a separate itemization of the sales tax, none had indeed been collected.

The taxpayer-purchaser is liable for a use tax on all articles purchased from a retailer for use in this state.⁹⁸ One way to extinguish this liability is to pay a sales tax on the same item, which can be evidenced by a receipt from the retailer.⁹⁹ Since the purchaser could not prove the prior payment of a sales tax, he was liable for the use tax.

Another interesting decision in the hearings division of the comptroller's office concerned the appropriate statute of limitations available to the comptroller in assessing deficiencies for sales and use taxes.¹⁰⁰ The controversy surrounded the construction of article 1.045(A), which provides a seven-year statute of limitations, unless "a shorter period of time" is otherwise provided.¹⁰¹ Such is the case under article 1.045(B),¹⁰² wherein a four-year statute is provided for sales and use taxes. Without more, no controversy would be present except that article 1.045(A)(3) allows taxes to be assessed *at any time* if there is a "gross error" in the return which would increase the tax payable by twenty-five percent or more.¹⁰³

In the instant case a "gross error" was clearly present, and the hearings examiner held that the sales and use taxes could be assessed in this circumstance, stating:

[Article 1.045] . . . paragraph B reads, in pertinent part, as follows: 'For the purpose of the . . . tax imposed by Chapter 20 of the Title, the period of time provided by *this Article* shall be four (4) years, and any provision of *Chapter 20* to the contrary is hereby repealed to the extent of such conflict.' . . . When Article 1.045 is read in its entirety, . . . [t]he reference in paragraph B to 'this Article', and the repeal of inconsistent provisions only in Chapter 20 lend strength to . . . [the Comp-

must provide such bond or security as the comptroller may reasonably require. "Indeed, it may be unreasonable for the Comptroller to decline to consider past taxpaying history when a retailer changes his form of business entity without substantially changing such factors as ownership, management and capitalization." TEX. ATT'Y GEN. OP. NO. H-468 (1974).

96. Comptroller's Dec. No. H-6774 (1975).

97. TEX. TAX.-GEN. ANN. art. 20.021(A) (Supp. 1975-76). In the normal consumer purchase of goods, the sales tax is added to the purchase price of the item and collected from the purchaser by the retailer. The retailer is then required to remit the sales tax to the state.

98. *Id.* art. 20.031(A) (1969). Compare this to the purchase of a business wherein the purchaser is liable for any sales taxes due and owing by the seller. *Id.* art. 20.09(I); Comptroller's Ruling No. 95-045, 1 CCH TEX. STATE TAX REP. ¶ 63-030a (1969).

99. TEX. TAX.-GEN. ANN. arts. 20.031(A), .04(K) (1969).

100. Comptroller's Dec. No. H-6360 (1975).

101. TEX. TAX.-GEN. ANN. art. 1.045(A) (1969).

102. *Id.* art. 1.045(B).

103. *Id.* art. 1.045(A)(3).

troller's argument that sales taxes may be assessed at any time when a 25 percent error in taxes due is ultimately found.]¹⁰⁴

B. Motor Vehicle Retail Sales and Use Tax

There were some legislative changes¹⁰⁵ and departmental rulings¹⁰⁶ in the motor vehicle retail sales and use tax area, but none were of great import. One recent decision in the hearings division of the comptroller's office¹⁰⁷ did, however, present an interesting question concerning the imposition of penalties and interest for failure to pay the motor vehicle sales tax. In that case, a sales tax was due upon the conversion of a motor vehicle from the status of rental use to lease use.¹⁰⁸ Surprisingly, the hearings examiner held that no penalties and interest could be assessed by reason of the taxpayer's failure to pay the appropriate tax when due. In reaching this decision, the hearings examiner held article 6.04 was not applicable, as that statutory provision was concerned only with the failure to pay gross rental receipts.¹⁰⁹ Further, article 6.06 had no application to the facts of this case, as that provision dealt with the seller's not reflecting the correct purchase price of the vehicle on the joint affidavit required by article 6.05.¹¹⁰ Here the

104. Comptroller's Dec. No. H-6360 (1975) (emphasis in original). See also TEX. ATT'Y GEN. OP. No. M-132 (1967); Comptroller's Dec. No. H-6917 (1975).

105. See TEX. TAX.-GEN. ANN. art. 6.01(9) (Supp. 1975-76) (imposition of use tax on certain persons to whom metal dealer license plates are issued); *id.* art. 6.01(9) (exempting motor vehicles leased to the state or a political subdivision thereof from the motor vehicle sales tax); *id.* art. 6.041 (providing the comptroller with power to revoke or suspend a motor vehicle retail seller's permit under certain circumstances, coupled with an appeals procedure in such an event).

It should be noted that a legislative drafting error is present in the numbering of new TEX. TAX.-GEN. ANN. art. 6.01(9) (Supp. 1975-76). The author's comments on a similar drafting error explained in footnote 81 *supra* are equally applicable to this legislative oversight.

106. Comptroller's Dec. No. H-6884 (1975) (use of vehicle for recreational trip to Mexico is not within exempt categorization of vehicle as a "demonstrator"); *id.* No. H-6640 (when a vehicle is converted from rental to lease use *only* the "owner's book value" under TEX. TAX.-GEN. ANN. art. 6.01(8) (Supp. 1975-76) determines the amount of sales tax due); Comptroller's Dec. No. H-6440 (1975) (under the clear statutory mandate of TEX. TAX.-GEN. ANN. art. 6.01(1) (Supp. 1975-76), the purchaser-lessor pays all motor vehicle sales taxes in the case of a lease, *i.e.*, a rental of more than 31 days); Letter from Comptroller of Public Accounts to Prentice-Hall, Feb. 5, 1975, P-H STATE & LOCAL TAXES ¶ 23,069 (1975) (cash rebates given by car manufacturers on purchase of new cars is considered to be a reduction in the purchase price of the automobile, with a corresponding reduction in the applicable sales tax).

107. Comptroller's Dec. No. H-6694 (1975).

108. See TEX. ATT'Y GEN. OP. No. H-380 (1974).

109. TEX. TAX.-GEN. ANN. art. 6.04 (Supp. 1975-76). In reaching this decision, the hearings examiner stated:

Article 6.04 of the Act in discussing the collection of the gross rental receipts tax states such tax shall be reported and paid in the same manner that the Limited Sales, Excise and Use Taxes of Texas are reported and paid by retailers under Article 20.05. Article 20.05(H) provides for penalty and interest, and it can be reasonably argued that this penalty and interest goes only to the reporting and paying of the gross rental receipts tax.

It is submitted that based upon the foregoing reasoning, the hearings examiner's decision is in error. See also TEX. ATT'Y GEN. OP. No. M-913 (1971). But see *id.* No. H-293 (1974) (tax assessor-collector has no authority to require parties to a prior sale to pay taxes due but unpaid on those sales, as he can only deny registration of vehicles if the sales taxes are not paid).

110. TEX. TAX.-GEN. ANN. arts. 6.05, 6.06 (1969).

taxpayer was not the "seller" contemplated by that statute, as he merely converted the use of the vehicle, but did not make any title transfer thereof.

IV. AD VALOREM TAXES¹¹¹

There was the usual flurry of decisions and legislative changes relating to ad valorem taxes, most of which are not of general interest. Included in this category were those cases and statutes discussing the taxable situs of property,¹¹² matters relating to the tax assessors-collectors of the various taxing entities,¹¹³ the application of revenue sharing funds,¹¹⁴ the special tax assessment of land held for "agricultural use,"¹¹⁵ the exemption for ad valorem tax purposes of property owned by charities and municipalities,¹¹⁶

111. For a critique of the Texas property tax system see Yudof, *The Property Tax in Texas Under State and Federal Law*, 51 TEXAS L. REV. 885 (1973). See also Levatino & Bickerstaff, *The Proposed Constitution for Texas*, 29 SW. L.J. 477, 495-505 (1975); Comment, *Equality in Taxation—Houston's Constitutional Dilemma*, 10 HOUS. L. REV. 656 (1973).

112. *McDaniel v. Castro County*, 514 S.W.2d 488 (Tex. Civ. App.—Amarillo 1974, writ ref'd n.r.e.) (Even though grazing land for cattle extended across two counties, taxpayer's cattle were not taxable in both counties under the proration formula contained in TEX. TAX-GEN. ANN. art. 7155 (1960), since the cattle were not free to roam the pasture, but were fenced totally within the boundaries of one county. Thus, only the county in which the cattle were physically located was entitled to the tax.).

113. TEX. REV. CIV. STAT. ANN. art. 7260, § 8 (Supp. 1975-76) (tax assessor-collector may refund ad valorem taxes in cases of a mistake acknowledged by the tax collector); *Saenz v. Lackey*, 522 S.W.2d 237 (Tex. Civ. App.—Corpus Christi 1975, writ ref'd n.r.e.) (taxpayers-property-owners had standing to bring a quo warranto action to oust already appointed tax assessor-collector from office); TEX. ATT'Y GEN. OP. NO. H-693 (1975) (Subject to sound administrative practice, cancelled bonds, bond coupons and county warrants may be destroyed by the county treasurer without the necessity of duplicating such instruments. There is no statutorily required retention time so long as they are retained long enough to permit the county auditor to complete his auditing duties and no order of the commissioner's court to that effect is necessary.); TEX. ATT'Y GEN. OP. NO. H-469 (1974) (the Houston Independent School District may appoint a tax assessor-collector for the school district, other than the tax assessor-collector for the city of Houston); TEX. ATT'Y GEN. ADVISORY LETTER NO. 86 (1974) (whether legal incompatibility of duties prevents a person from serving simultaneously as a tax assessor-collector for a school district and as a city commissioner in a city located within that district is a question of fact); TEX. ATT'Y GEN. OPEN REC. DEC. NO. 112 (1975) (city tax department appraisal cards are public information under the Open Records Act); *id.* NO. 98 (in the absence of any assertion of privacy rights by the individual involved, a "hot check" given to a local tax assessor-collector is public information); *id.* NO. 39 (1974) (information provided by banks to local tax assessor-collector showing the identity and address of bank stockholders, the size and value of their stockholdings, is public information).

114. TEX. ATT'Y GEN. OP. NO. H-454 (1974) (under TEX. CONST. art. IX, § 13 El Paso County can use a portion of its revenue sharing funds to contract with the El Paso Hospital District for the establishment, maintenance, and support of mental health and retardation services, public health units and clinics, and related public health activities); TEX. ATT'Y GEN. ADVISORY LETTER NO. 101 (1975) (a county may transfer to a hospital district that portion of the county's federal revenue sharing funds which are attributable to the hospital district's taxing efforts).

115. *Gragg v. Cayuga Ind. School Dist.*, 525 S.W.2d 32 (Tex. Civ. App.—Tyler 1975, writ granted) (To receive special tax treatment by designating land as being for "agricultural use," the taxpayer must prove that agriculture is his primary occupation and source of income. In making this determination, all sources of income, including that from interest, dividends, office rentals, oil and gas properties, sales of corporate stock, etc., must be considered.); TEX. ATT'Y GEN. ADVISORY LETTER NO. 109 (1975) (in computing the county economic index, there is no constitutional prohibition in valuing farm and ranch land on the "agricultural use" basis rather than at its actual market value).

116. TEX. REV. CIV. STAT. ANN. art. 7150, § 20 (Supp. 1975-76) (exemption of certain property owned by the American G.I. Forum); *id.* § 22 (exemption of certain

ad valorem tax procedures,¹¹⁷ and other miscellaneous matters.¹¹⁸

A case of particular importance during the survey period was *Hill v.*

property owned by nonprofit youth athletic corporations); *id.* art. 7150h (exemption of property owned by disabled veterans and survivors of deceased veterans); *id.* art. 7150j (relating to notification of availability of exemptions for persons 65 years of age and older); *Aransas Hospital, Inc. v. Aransas Pass Ind. School Dist.*, 521 S.W.2d 685 (Tex. Civ. App.—Corpus Christi 1975, writ ref'd n.r.e.) (hospital denied exemption, as it failed to prove that it benefited, through absolute charity, persons definite in number by preventing them from becoming burdens to society); *City of McAllen v. Ev. Lutheran Good Samaritan Society*, 518 S.W.2d 557 (Tex. Civ. App.—Corpus Christi), *aff'd*, 530 S.W.2d 806 (Tex. 1975) (nursing home held to be exempt as a purely public charity, since no one was denied admission or discharged therefrom due to inability to pay, profits were not used for private gain, and home assumed, to some extent, burdens which would otherwise fall on society); *Canatillo Ind. School Dist. v. City of El Paso*, 514 S.W.2d 466 (Tex. Civ. App.—El Paso 1974, writ ref'd) (lands belonging to a city lying within a school district are exempt from the ad valorem taxes levied by the district, regardless of whether or not the city's land is used for public purposes); TEX. ATT'Y GEN. OP. NO. H-570 (1975) (during the interim period after a governmental unit takes possession of real property pursuant to the condemnation laws, and before the taking is held to be invalid, the realty is tax-exempt property owned by the condemning governmental unit); *id.* NO. H-548 (although a taxpayer must be age 65 on or before January 1 of a particular year in which he claims a homestead exemption for persons over age 65 under the authority of TEX. CONST. art. VIII, § 1-b, the political subdivision providing this exemption cannot enact an administrative cutoff date for claiming the exemption, which would have the effect of nullifying the benefits for a homestead exemption); TEX. ATT'Y GEN. OP. NO. H-462 (1974) (county owned property which is otherwise exempt does not lose its exempt status merely because it is located in another county).

117. TEX. EDUC. CODE ANN. arts. 20.03, 22.11(b) (Supp. 1975-76) (valuation and assessment percentage to be used for school tax purposes of property situated in common school districts); *id.* art. 25.07 (assessment and collection of taxes by rural high school districts); TEX. REV. CIV. STAT. ANN. art. 1105b (Supp. 1975-76) (validation of certain municipal special assessments and reassessments); *id.* art. 2039b (procedures in addition to TEX. R. CIV. P. 117a relating to citation of nonresidents for tax purposes); TEX. REV. CIV. STAT. ANN. art. 7261, § 7 (Supp. 1975-76) (erroneous payment or an overpayment of ad valorem taxes may be refunded to the taxpayer, if an application for refund is filed within three years from the date of such payment); *id.* art. 7359 (allows tax assessor-collector of county in which city is located to collect certain ad valorem taxes imposed by the city and provides for the payment of costs of collections and fees to the tax assessor-collector); *Anderson v. Collum*, 514 S.W.2d 230 (Tex. 1974) (Where the owners were residents and could have been found with diligent inquiry and where state's affidavit for citation by publication alleged only that the owner was a nonresident or person whose residence was unknown, service by publication was ineffective and the sale and sheriff's deed would be annulled. However, the judgment itself foreclosing the state's tax lien will not be disturbed.); *Gragg v. Cayuga Ind. School Dist.*, 525 S.W.2d 32 (Tex. Civ. App.—Tyler 1975, writ granted) (in order to void a method of assessing property as being unconstitutional, the taxpayer must show not only that the plan is arbitrary and illegal, but also that the use of the plan caused the taxpayer substantial injury); *accord*, *Neville v. Cass County*, 523 S.W.2d 419 (Tex. Civ. App.—Texarkana 1975, writ ref'd n.r.e.); *Bynum v. Alto Ind. School Dist.*, 521 S.W.2d 656 (Tex. Civ. App.—Tyler 1975, writ ref'd n.r.e.); *Sierra Blanca Ind. School Dist. v. Sierra Blanca Corp.*, 514 S.W.2d 782 (Tex. Civ. App.—El Paso 1974, writ ref'd n.r.e.); TEX. ATT'Y GEN. OP. NO. H-576 (1975) (when city appoints county tax assessor-collector to collect city taxes under the authority of TEX. REV. CIV. STAT. ANN. art. 1042b (Supp. 1975-76), the county tax assessor-collector is required to assume collection of all delinquent and current taxes owed the city, even though the city's ratio of assessment for prior years has been different from that of the county); TEX. ATT'Y GEN. OP. NO. H-514 (1975) (Under a usual contract of sale, the purchaser of land acquires equitable title and, if in possession, he is liable for taxes assessed against the property. Where a mobile home is placed on land and both are owned by the same person, the value of the mobile home should be included with the value of the land unless it is unoccupied and for sale or has been within the taxing jurisdiction for less than 60 days. Under similar circumstances, where both are owned by the same person, land may be charged with liability for taxes rendered against a mobile home.); TEX. ATT'Y GEN. ADVISORY LETTER NO. 7 (1974) (the state ad valorem tax levied by TEX. CONST. art. VII, § 17 continues indefinitely, rather than expiring on December 31, 1987).

118. *Great Eastern Life Ins. Co. v. Jones*, 526 S.W.2d 268 (Tex. Civ. App.—Beau-

Stone,¹¹⁹ in which the United States Supreme Court was confronted with the constitutionality of certain election practices in Texas. The Texas Constitution provides that in elections "to determine the expenditure of money or assumption of debt," only those who pay property taxes may vote.¹²⁰ Further, in elections concerning the issuance of bonds, only those persons who own taxable property in the district where the election is held and who render such property for taxation are eligible to vote.¹²¹

mont 1975, writ ref'd n.r.e.) (where common law wife did not join in execution of mechanic's lien and deed of trust, the lien created thereby was void and the lienholder which paid delinquent taxes on the property did not become subrogated to the tax liens); TEX. ATT'Y GEN. OP. No. H-617 (1975) (appropriations for the Legislative Property Tax Committee expired May 31, 1975); *id.* No. H-579 (A county may expend moneys from its general fund for the maintenance and operation of parks without holding an election to levy a park tax. A county may expend moneys from its general fund for the acquisition and improvement of parks without holding an election to levy a park tax provided the county's permanent improvement fund has been consolidated with its general fund; otherwise, such expenditures must be made from the permanent improvement fund.); *id.* No. H-530 (although revenues in the farm to market lateral tax fund may be expended only for the purposes enumerated in TEX. CONST. art. VIII, § 1-a, revenues in the road and bridge fund may be transferred to the general fund and expended for any lawful purpose); TEX. ATT'Y GEN. OP. No. H-479 (1974) (If property is not consigned, it does not qualify for the tax exemption provided in TEX. REV. CIV. STAT. ANN. art. 7150f (Supp. 1975-76). Consigned property is that which is deposited with another for care or sale, title to which remains in the consignor.); TEX. ATT'Y GEN. OP. No. H-448 (1974) (The commissioner of education should require each county's tax assessor to report the percentage of market value used in determining the assessed value of property in that county. The commissioner should use this information in computing the county economic index to achieve uniformity of property values of each county as compared with every other county.).

119. 421 U.S. 289 (1975).

120. TEX. CONST. art. VI, § 3. In Thomas, *Interpretive Commentary*, 2 TEX. CONST. 355 (1955), this provision is explained as follows:

In the Constitutional Convention of 1875, long debates were held over the question of whether suffrage was a privilege conferred by the government and could therefore be regulated by it for the good of the people, or whether suffrage was a natural, absolute right which men possessed over and above government.

Although the majority favored the latter viewpoint, when it came to the issue of local finances, the natural right philosophy was discreetly overlooked in favor of decidedly materialistic considerations. Thus Art. 6, Sec. 3, although acknowledging a general right to vote in municipal or town elections, severely limited this general right to property owners on questions dealing with the expenditure of money or the assumption of debts. Underlying this restriction was the recognition that as the property owners were, in the long run, the people who would be responsible for payment of the debt, they alone should be privileged to say whether or not such debt was necessary or desirable.

Having disfranchised non-property owners on this issue, a proviso was added that non-property owners should be protected from the property owners by providing that no poll tax could be levied on them for the payment of local debts.

121. TEX. CONST. art. VI, § 3a. The commentary to this provision, Thomas, *Interpretive Commentary*, 2 TEX. CONST. 359 (1955), states, in part:

In *Hillsman v. Faison*, 23 Tex. App. 398, 57 S.W. 920, it was held that one who pays taxes means a taxpayer, and it was determined that a taxpayer, in the light of Art. 6, Sec. 3, is one who owns property in the town or city subject to tax. The court declared that it was not necessary that the property tax be actually paid. Thus, a voter could appear on election day, prove he owned property, and vote on financial questions. The result was that many persons were allowed to vote in elections on this question without having any property on the tax roll, and in fact without paying any taxes to the town or city at all. In order to cure this evil, Sec. 3a stipulated that the voter was under the further obligation to render such property for taxation, and thereby become liable for a pro rata share of the taxes levied and assessed.

In *Stone* a bond election was held in the city of Fort Worth under a "dual box election procedure"¹²² to authorize bonds for improvement of the city transportation system and construction of a new library. The transportation issue was approved by the property and non-property owners, separately and in the aggregate. However, the proposition to authorize bonds for a new library, although receiving a majority of the total number of votes cast, failed to receive a majority of votes cast by the property owners. As was required in this circumstance, bond authorization to finance construction of a new library was defeated.

The constitutional attack on the Texas Constitution stems from *Kramer v. Union Free School District No. 15*,¹²³ wherein the United States Supreme Court held that in an election of general interest, restrictions on voting rights other than age, residence, and citizenship must be founded upon a "compelling state interest" in order to survive a constitutional attack. In *Stone*, after first determining that the bond election was of general interest,¹²⁴ the Court next considered whether there was a compelling state interest to be served in requiring the populace to have "rendered" property for taxation in order to be eligible to vote. In finding no such compelling interest, the Court brushed aside each of the state's arguments:

The appellant [Texas] has sought to justify the State's rendering requirement solely on the ground that it extends some protection to property owners, who will bear the direct burden of retiring the city's bonded indebtedness. . . . Even under a system in which the responsibility of retiring the bonded indebtedness falls directly on property taxpayers, all members of the community share in the cost in various ways. . . . Quite apart from the general interest of the library bond election, the appellant's contention that the rendering requirement imposes no real impediment to participation itself undercuts the claim that it serves the purpose of protecting those who will bear the burden of the debt obligations. If anyone can become eligible to vote by rendering property of even negligible value, the rendering requirement can hardly be said to select voters according to the magnitude of their prospective liability for the city's indebtedness.

The appellee city officials argue that the rendering qualification furthers another state interest: it encourages prospective voters to render their property and thereby helps enforce the State's tax laws. . . .

122. After the United States Supreme Court's decision in *Kramer v. Union Free School Dist. No. 15*, 395 U.S. 621 (1969), and *Cipriano v. City of Houma*, 395 U.S. 701 (1969), the Texas Attorney General devised the "dual box election procedure" to be used in the state's local bond elections. The Court described this procedure to be as follows:

[A]ll persons owning taxable property rendered for taxation voted in one box, and all other registered voters cast their ballots in a separate box. The results in both boxes were tabulated, and the bond issue would be deemed to have passed only if it was approved by a majority vote both in the 'renders' box' and in the aggregate of both boxes. This scheme ensured that the bonds would be safe from challenge even if the state law restrictions on the franchise were later held unconstitutional.

Hill v. Stone, 421 U.S. 289, 292 (1975).

123. 395 U.S. 621 (1969).

124. The Court stated that: "[A] general obligation bond issue—even where the debt service will be paid entirely out of property taxes as in Ft. Worth—is a matter of general interest, and . . . the principles of *Kramer* apply to classifications limiting eligibility among registered voters." 421 U.S. at 297-98.

[This argument] seems particularly dubious here, since under the State's construction of the rendering requirement, an individual will be given the right to vote if he renders any property at all, no matter how trivial. Those rendering solely to earn the right to vote in bond elections may well render property of minimal value, in order to qualify for voting without imposing upon themselves a substantial tax liability. The rendering requirement thus seems unlikely to have any significant impact on the asserted state policy of encouraging each person to render all of his property.¹²⁵

This decision, to which a vigorous dissent was filed,¹²⁶ means that *all voters* must be given the opportunity to vote and decide bond elections. It is submitted that there will be few situations wherein a special interest election could be found which would allow Texas to continue its rendering method to determine eligible voters. It is interesting to note that as regards Texas elections, this decision is controlling for all elections which were not final on March 24, 1974, the date of the district court's decision; whereas, for other jurisdictions having restrictive voting requirements similar to those in Texas, these principles apply to any bond elections which were legally incomplete on May 12, 1975, the date of this decision.¹²⁷

V. FEDERAL AND MISCELLANEOUS TAXES

A. *Miscellaneous State Tax Matters*

There was a myriad of legislative changes and court and administrative

125. *Id.* at 298-300. See generally Note, *The Equal Protection Clause v. Restriction of the Franchise to Property Owners in Texas*, 22 BAYLOR L. REV. 594 (1970); Note, *Property Ownership Versus the Right to Vote: A Question of Equal Protection*, 25 SW. L.J. 633 (1971).

126. The dissent's position was stated as follows:

Appellees in the instant case have not drawn our attention to a totally propertyless citizen of Fort Worth, poorer than Diogenes, whose total lack of ownership precludes him from complying with the rendition requirement. Instead, the alleged deprived class in the instant case consists of those who violated their legal obligation under state law, choosing not to render any property by reason of carelessness, a tax avoidance motive, or otherwise. And the alleged deprivation of equal protection lies in self-disenfranchisement caused by their failure to utilize readily available facilities to render property. . . .

The Court distinguishes . . . our decision in *Rosario* on the grounds that the New York registration requirement involved in that case, unlike the Texas rendering qualification for bond elections, was directed towards 'preserving the integrity of the electoral process.'

As a factual matter, the offered distinction is a doubtful one. The purpose sought to be served by the registration requirement examined in *Rosario* was the prevention of 'raiding': the crossing of party lines by members of one party in order to affect the outcome of the primary election of another political party. The rendering qualification under challenge in the instant case is designed in part to prevent citizens who violate their legal obligations by totally avoiding any portion of their fair share of obligations resulting from a bond election, however small that share may be, from influencing the process which results in the imposition of such obligations. If the integrity of the electoral process is violated by allowing citizens, who are unwilling to assume the responsibilities of party membership, to vote in party primaries, it is difficult to understand how it is less violated by allowing citizens, who are unwilling to assume their fair share of the obligations occurring from a bond election, to vote in such an election.

421 U.S. at 303-04, 306-07.

127. *Id.* at 301; accord, *Ex parte Southland Ind. School Dist.*, 518 S.W.2d 921 (Tex. Civ. App.—Amarillo 1975, no writ).

decisions concerning various state tax matters during the past survey period which are of little general interest. Topics included in this category are matters relating to the admissions tax,¹²⁸ alcoholic beverages,¹²⁹ coin-operated machines,¹³⁰ various procedural matters,¹³¹ and other miscellaneous considerations.¹³²

128. TEX. TAX-GEN. ANN. art. 21.02(2)-(4) (Supp. 1975-76) (relating to applicability of admissions tax to skating rinks and exempting motorcycle racing contests and exhibitions from tax); *Dance Town, U.S.A., Inc. v. Calvert*, 519 S.W.2d 523 (Tex. Civ. App.—Beaumont 1975, writ ref'd n.r.e.) (A tavern imposed an advertised admission charge of 50 cents and a service charge of 50 cents, with only those patrons who paid the service as well as the admission charge being entitled to make advance reservations, sit at a table, make purchases at the bar, or be served by waitresses. There were few requests to be admitted for the admission charge only, and employees were allegedly instructed to watch patrons admitted for admission charge only and insure that they did not receive any services in the tavern. Held, the service charge was a part of the admission charge, and thus subject to taxation as an admission charge in excess of 51 cents.).

129. TEX. PEN. AUX. LAWS ANN. art. 666-21e (1975 Pamphlet) (allowing importation of liquor bottled in containers sized under the metric system and to calculate the taxes collected thereon by converting the United States standard gallon measurement system to the metric system); TEX. ATT'Y GEN. OP. No. H-630 (1975) (TEX. TAX-GEN. ANN. art. 1.05 (1969) and TEX. REV. CIV. STAT. ANN. art. 7057b (1960) are applicable to a private club license fee, so that this fee can be paid under protest to the alcoholic beverage commission).

130. TEX. TAX-GEN. ANN. arts. 13.01-.17 (Supp. 1975-76) (complete revision of tax provisions for coin-operated machines); *Taylor v. Texas*, 513 S.W.2d 549 (Tex. Crim. App. 1974) (TEX. TAX-GEN. ANN. art. 13.17(16), ch. 587, § 5, [1971] Tex. Laws 1943, establishes a classification system which is unreasonable, arbitrary and capricious, thus being unconstitutional); TEX. ATT'Y GEN. OP. No. H-719 (1975) (under TEX. TAX-GEN. ANN. arts. 13.01, 13.03 (Supp. 1975-76) a coin-operated television is subject to taxation).

131. TEX. REV. CIV. STAT. ANN. art. 4351b, §§ 1-4 (Supp. 1975-76) (procedure for qualifying miscellaneous claims against state and their payment by the comptroller); TEX. REV. CIV. STAT. ANN. art. 6675a-5f (Supp. 1975-76) (establishing procedure for refunding of motor vehicle registration fees); TEX. TAX-GEN. ANN. art. 1.13(h) (Supp. 1975-76) (authorizing comptroller in certain instances to grant a reasonable time, not to exceed 45 days, in which to file tax returns, if payment of 90% of the estimated tax accompanies return); *id.* art. 1.13A (eliminating penalty and interest provisions if comptroller determines that taxpayer exercised reasonable diligence in attempting to comply with filing requirements of tax statutes); *id.* art. 1.034 (except in the case of sales and use taxes, the comptroller is authorized to modify the dates prescribed for filing tax returns and paying taxes); TEX. ATT'Y GEN. OP. No. H-720 (1975) (TEX. TAX-GEN. ANN. art. 1.07(1)(f)(ii) (1969) providing for the freezing of a person's bank deposits on the basis of an administrative decision by the comptroller is constitutional); TEX. ATT'Y GEN. OP. No. H-661 (1975) (The comptroller may not release information as to the amounts of sales or use tax paid by a particular taxpayer. Although the comptroller may disclose the existence of a dispute with a particular taxpayer as to the amount of tax which the taxpayer owes to the state, he may not disclose the amount in controversy prior to making a final determination if doing so would indicate the amount of the taxpayer's gross sales.); *id.* No. H-622 (discusses effect on comptroller's certification of general appropriations bill, when a page from that bill was inadvertently omitted).

132. TEX. INS. CODE ANN. arts. 23.08(b), (c) (Supp. 1975-76) (a 1% tax is levied on all revenues received by nonprofit legal services corporation for the issuance of prepaid legal services contracts, in lieu of any franchise or gross receipts tax); *id.* art. 21.28-C, § 15 (providing that amounts paid by insurers as assessment under this Act can be taken as credit against its premium tax in certain optional situations); TEX. TAX-GEN. ANN. art. 7.08(9) (Supp. 1975-76) (relating to the date for payment of cigarette or cigar stamps or meter settings received by distributors); *id.* art. 8.02 (broadening the category of all tobacco cigars for cigar tax purposes); *Conlen Grain & Mercantile, Inc. v. Texas Grain Sorghum Producers*, 519 S.W.2d 620 (Tex. 1975) (the Texas Commodity Referendum Act, TEX. REV. CIV. STAT. ANN. art. 55c (1969), *as amended*, (Supp. 1975-76), in providing assessments on "processors" of grain sorghum which must be collected from the "producers" of such grain, is an attempt to levy an occupation tax on agriculture, and is thus unconstitutional under TEX. CONST. art. VIII, § 1 (1955)). *See also* *Austin v. New Hampshire*, 420 U.S. 656 (1975) (The New Hampshire commuters in-

Some recent legislative changes, although not strictly tax legislation, represent the more important miscellaneous tax developments. First, the Texas Trust Act has been amended to specifically allow the designation of an inter vivos or testamentary trustee as the recipient of benefits payable from a qualified pension or profit-sharing plan on an employee's death.¹³³ This new provision eliminates some prior concern as to whether a testamentary trustee could be the recipient of such funds.¹³⁴ Further, the statute clearly provides that these proceeds are not subject to the decedent's debts or taxes, nor are they a part of the probate estate. Thus, unless the trust agreement or will provides to the contrary, employee benefits payable on the death of the employee will not be subject to the federal estate¹³⁵ or Texas inheritance tax.¹³⁶

Another legislative addition was section 230(b) of the Texas Probate Code. Under this new provision, upon showing that a ward will probably remain incompetent during the remainder of his lifetime, the guardian can request the court to "authorize the guardian to apply such principal or income of the ward's estate as is not required for the support of the ward during his lifetime or of his family towards the establishment of an estate plan for the purpose of minimizing income, estate, inheritance, or other taxes payable out of the ward's estate."¹³⁷ Although the guardian could request the court to approve charitable contributions from the ward's estate in certain situations,¹³⁸ there was no method previously available to make those gifts enumerated in the statute.¹³⁹ Indeed, the courts had held prior to this amendment that the

come tax imposes a tax on nonresidents' New Hampshire-derived income above \$2,000.00 at a 4% rate, except that if the nonresident's state of residence would impose a lesser tax had the income been earned in that state, the New Hampshire tax is reduced to that amount. The commuters income tax contains provisions that in practical effect exempt from tax income earned by New Hampshire residents outside the state, and New Hampshire imposes no tax on its residents' domestic earned income. Under the rule requiring substantial equality of treatment for the citizens of the taxing state and non-resident taxpayers, the New Hampshire commuters income tax violates the privileges and immunities clause, since the tax falls exclusively on nonresidents' incomes and is not offset even approximately by other taxes imposed upon residents alone.).

133. TEX. REV. CIV. STAT. ANN. art. 7425d-1 (Supp. 1975-76).

134. See Brorby, *Designation of Inter Vivos or Testamentary Trustee as Beneficiary of Employee Benefits*, 24 TAX LAW. 141 (1970).

135. INT. REV. CODE OF 1954, § 2039(c); see Rev. Rul. 73-404, 1973-2 CUM. BULL. 319.

The new provisions of TEX. REV. CIV. STAT. ANN. art. 7425d-1 (Supp. 1975-76) do not contain a provision similar to INT. REV. CODE OF 1954, § 2039(d). This latter provision was added in 1972 to assure that the non-employee spouse's community property interest in the employee's account in the qualified pension or profit-sharing plan was not subject to estate taxation in the event the non-employee spouse predeceased the employee. See generally Adkins, *Handling the Non-Employee Spouse's Interest in a Qualified Plan in Texas*, 5 STATE BAR OF TEXAS, NEWSLETTER OF THE SECTION OF TAXATION, No. 2, July 1972, at 11-14; Comment, *The Wife's Community Interest in Her Husband's Qualified Pension or Profit Sharing Plan*, 50 TEXAS L. REV. 334 (1972).

136. TEX. TAX-GEN. ANN. art. 14.015(4) (1969).

137. TEX. PROB. CODE ANN. art. 230(b)(2)(A) (Supp. 1975-76).

138. *Id.* art. 398 (1956).

139. These gifts may be made to:

- (i) organizations to which charitable contributions may be made under the Internal Revenue Code and in which it is shown the ward would reasonably have an interest, (ii) the ward's heirs at law who are identifiable at the time of the order, (iii) devisees under the ward's last validly executed will, if there be such a will, (iv) and a person serving as guardian of

probate court did not have the power to authorize such gifts.¹⁴⁰ Thus, a very beneficial tool has been provided by this new statutory provision.

A question left unanswered by this new provision of the Probate Code is the effect of the gift on the ward's gross estate for tax purposes. It must be assumed that a valid gift will be deemed to have been made by the ward.¹⁴¹ That being the case, a question will arise as to the includability of the gift in the ward's gross estate for federal estate¹⁴² and Texas inheritance tax purposes¹⁴³ if he should die within three years of the gift. Normally, such gifts would be presumed to be made in contemplation of death unless "lifetime motives" were shown for the gift,¹⁴⁴ and, thus, includable in the decedent's gross estate. Unless this test is to be applied on the basis of a theoretical "competent" donor, all such gifts are likely to be deemed in contemplation of death, and thus includable in the ward's gross estate for tax purposes.

B. Federal Taxes

Although there were a few decisions concerning the application of the federal tax laws to the community property system in general, or Texas in particular, a complete discussion of these cases is beyond the scope of this Article.¹⁴⁵ A development of prime importance in the estate planning area

the ward provided he is eligible under either category (ii) or (iii) above. *Id.* art. 230(b)(2)(A) (Supp. 1975-76).

140. *In re Guardianship of Neal*, 406 S.W.2d 496 (Tex. Civ. App.—Houston 1966, writ ref'd n.r.e.). See generally Comment, *Gifts by Guardians: Texas Rejects Substitution of Judgment Doctrine*, 19 BAYLOR L. REV. 411 (1967); 45 TEXAS L. REV. 803 (1967).

141. TEX. PROB. CODE ANN. art. 230(b)(2)(B) (Supp. 1975-76) provides in part:

The application shall also indicate that the planned disposition is consistent with the intentions of the ward insofar as they can be ascertained. If the ward's intentions cannot be ascertained, the ward will be presumed to favor reduction in the incidence of the various forms of taxation and the partial distribution of his estate as herein provided.

142. INT. REV. CODE OF 1954, § 2035. See generally R. STEPHENS, G. MAXFIELD & S. LIND, *supra* note 9, at 4-61 to -75.

143. TEX. TAX-GEN. ANN. art. 14.01(B) (Supp. 1975-76). See generally Tracy, *supra* note 61, at 326-28.

144. The "dominant motive" for the transfer must be related to life rather than death considerations. As stated by the Court in *United States v. Wells*, 283 U.S. 102, 117-18 (1931):

It is contemplation of death, not necessarily contemplation of imminent death, to which the statute refers. . . . Old age may give premonitions and promptings independent of mortal disease. Yet age in itself cannot be regarded as furnishing a decisive test, for sound health and purposes associated with life, rather than with death, may motivate the transfer. The words 'in contemplation of death' mean that the thought of death is the impelling cause of the transfer, and while the belief in the imminence of death may afford convincing evidence, the statute is not to be limited, and its purpose thwarted, by a rule of construction which in place of contemplation of death makes the final criterion to be an apprehension that death is 'near at hand.'

145. *Ray v. United States*, 35 Am. Fed. Tax R.2d 75-1563 (S.D. Tex. 1974) (Full value of United States treasury bonds purchased by terminally ill decedent with funds he borrowed as his separate property is includable in his gross estate and redeemable at par to pay estate taxes, and the entire loan is deductible as his separate debt. Both the promissory note signed by decedent and the security agreement pledging the bonds as security for the loan provided that the proceeds of the loan were his separate property and that only his separate property, including the bonds, was liable for repayment. Therefore, the value of these bonds could be used in calculating the decedent's adjusted

for the Texas practitioner is Revenue Ruling 75-504.¹⁴⁶ In the facts on which this ruling was based a husband and wife were lifelong residents of Texas, and on August 18, 1970, the husband gave his wife \$15,000.00 in cash from his separate property. The wife placed this money in a separate savings account and at the husband's death on December 10, 1973, the principal of the account was still intact with \$3,058.00 in accumulated interest also being credited to the fund.¹⁴⁷

Looking first to Texas community property law, the Service determined that, with certain exceptions not relevant here, income accrued during marriage from the separate property of a spouse is characterized as community property.¹⁴⁸ This being the case, the decedent was entitled to one-half of the interest income accrued on the gift to his wife, as his community property interest therein. From this it was reasoned that one-half of the fair market value of the savings account on the date of the decedent's death, here \$7,500.00, was includable in his gross estate as a transfer with a retained interest.¹⁴⁹ Also, \$1,529.00 representing one-half of the accrued interest from this account was includable in the decedent's gross estate as his community property portion thereof.¹⁵⁰

gross estate for purposes of determining the maximum marital deduction.); Mildred L. Frehland, P-H Tax Ct. Mem. ¶ 75,300 (1975) (During year 1967 husband and wife resided in Texas and were married for the entire year, although a divorce petition was filed in that year and the divorce was granted in 1968. Consequently, wife is liable for one-half of community income and the income tax thereon. The innocent spouse rule has no application here, since the wife had filed a separate return for the year 1967.); Rev. Rul. 75-240, 1975 INT. REV. BULL. No. 25, at 16 (at the time of her husband's death, a non-employee surviving spouse in a community property state is subject to the gift tax imposed under INT. REV. CODE OF 1954, § 2501, by reason of the death benefit transferred to a designated third party beneficiary pursuant to her husband's qualified profit-sharing retirement plan, and the exclusion provided by INT. REV. CODE OF 1954, § 2517(a) is not applicable).

146. Rev. Rul. 75-504, 1975 INT. REV. BULL. No. 47, at 14.

147. It should be noted that since the decedent survived three years after making this gift, there was no question of the gift being in contemplation of death under INT. REV. CODE OF 1954, § 2035. Further, no question was raised regarding any managerial powers *A* might have had over the income from the property transferred to *B*, so as possibly to invoke §§ 2036 or 2038 of the Code. See *United States v. Goodyear*, 99 F.2d 523 (9th Cir. 1938) (managerial powers are not taxable).

148. See *Hammond v. Commissioner*, 106 F.2d 420 (10th Cir. 1939); *Moss v. Gibbs*, 370 S.W.2d 452 (Tex. 1963); *Arnold v. Leonard*, 114 Tex. 535, 273 S.W. 799 (1925). See generally Jackson, *Community Property and Federal Taxes*, 12 Sw. L.J. 1, 8-16 (1958). Some "exceptions" to this general rule include: (a) Stock dividends declared on separate property stocks are separate property. *Scofield v. Weiss*, 131 F.2d 631 (5th Cir. 1942). (b) Royalties and bonuses on separate property minerals are separate property. *Commissioner v. Wilson*, 76 F.2d 766 (5th Cir. 1935). See also *Crabb v. Commissioner*, 119 F.2d 772 (5th Cir. 1941). (c) Inherent increases in the value of separate property (i.e., appreciation in value) are separate property. *Commissioner v. Skaggs*, 122 F.2d 721 (5th Cir. 1941); *O'Connor v. Commissioner*, 110 F.2d 652 (5th Cir. 1940).

149. INT. REV. CODE OF 1954, § 2036. Only that portion of the transferred property from which the donor-spouse "retained" an income interest (here one-half) was includable in his gross estate. This is based upon Treas. Reg. § 20.2036-1(a) (1958) which provides in part:

If the decedent retained or reserved an interest or right with respect to a part only of the property transferred by him, the amount to be included in his gross estate under section 2036 is only a corresponding proportion of . . . (the value of the entire property less only the value of any outstanding income interest which is not subject to the decedent's interest or right and which is actually being enjoyed by another person at the time of the decedent's death).

150. INT. REV. CODE OF 1954, § 2033.

Although the Service apparently will attempt to apply this rule only against income-producing property,¹⁵¹ the estate planner in Texas is faced with some unique possibilities. If the donor-spouse transfers separate income-producing property to the other spouse, one-half of this property would be includable in the donor's gross estate. However, if this one-half interest passes to the surviving spouse, it may qualify for the marital deduction.¹⁵² If that is true, then, in net effect, slightly more than one-quarter of the gift is includable in the donor-spouse's gross estate for tax purposes.¹⁵³ This should be compared with a retention of this property by the donor-spouse. Assuming in this latter instance that the property is transferred to the other spouse and still qualifies for the marital deduction, the net effect would be the inclusion of slightly more than one-half of this property in the donor-spouse's gross estate for tax purposes.

Although Revenue Ruling 75-504 dealt directly with the situation where the donor-spouse transfers separate property, the ruling's major significance may lie in the area of transfers of community property. In other cases where the decedent has transferred community property, to a trust, for example, with a retained life estate, it is clear that the portion of the trust includable in the decedent's gross estate is the fair market value of the transferred community property interest (one-half of the total) and not one-half of the decedent's community property interest therein (one-fourth of the total fund).¹⁵⁴ Based upon this premise, it would logically follow that when the donor-spouse transferred income-producing community property to the other spouse, for example, dividend producing stock, one-half of the fair market value of the stock on the date of the decedent's death is includable in his estate.¹⁵⁵

151. See Daly, *Estate Taxation of Inter-Spousal Transfers in Texas*, 7 STATE BAR OF TEXAS, NEWSLETTER OF THE SECTION OF TAXATION, No. 2, Apr. 1974, at 1-3.

152. INT. REV. CODE OF 1954, § 2056. It should be noted that although separate property was involved in Revenue Ruling 75-504, the question of a portion of this property qualifying for the marital deduction was not discussed.

153. Something less than one-half of the decedent's separate property is available for the maximum marital deduction. This stems from the calculation of the "adjusted gross estate" which determines the maximum allowable deduction. See generally R. STEPHENS, G. MAXFIELD & S. LIND, *supra* note 9, at 5-78 to -79.

154. See Johanson, *Revocable Trusts, Widow Election Wills, and Community Property: The Tax Problems*, 47 TEXAS L. REV. 1247, 1253-58 (1969); Estate of Daisy F. Christ, 54 T.C. 493 (1970), *aff'd on other grounds*, 480 F.2d 171 (9th Cir. 1973).

155. In reaching this conclusion, it should be borne in mind that the Service in Revenue Ruling 75-504 declined to follow certain language in *Commissioner v. Hinds*, 180 F.2d 930 (5th Cir. 1950). In that case, a husband and wife transferred community property to a New York trust company to pay income to the wife. The Tax Court held that the deceased husband had retained the use and enjoyment of only one-half of his community property interest transferred (one-fourth of the total property). The Commissioner on appeal argued that the decedent's full one-half of the community property transferred should be includable in his estate. The court went on to state:

The taxpayer, who because she thought the amount of tax imposed under the decision was too small to justify further litigation, did not appeal from it, is here urging upon us that it should be affirmed on the commissioner's appeal, not because it is right, but because it gave the commissioner more than he was entitled to, and he cannot, therefore, complain of it.

We agree with the taxpayer. Without, therefore, at all approving the decision of the Tax Court, or deciding the point so much labored here by the commissioner and taxpayer, but unnecessary to the decision of this case, whether the income from the property was, within the decision of *Commissioner of Internal Revenue v. Porter*, 5 Cir., 148 F.2d 566, community property, we deny the petition for review. We do this upon the

An interesting estate planning tool in working with this ruling and income-producing community property could be the use of a statutory partition.¹⁵⁶ First, assume the couple partitioned \$1,000.00 in cash so that each owned \$500.00 as separate property. The donor-spouse transfers his \$500.00 of separate property to the other spouse. Under the rationale of Revenue Ruling 75-504 only \$250.00 would be includable in the decedent's gross estate,¹⁵⁷ whereas \$500.00 would have been includable if the income-producing property had been transferred outright. Secondly, after a partition, the donee-spouse could invest in property which would not produce community property income.¹⁵⁸ Thus, the entire \$500.00 would be excluded from the donor-spouse's estate, assuming he lived for three years after the transfer.

Whether income-producing separate or community property is considered, Revenue Ruling 75-504 has created some very difficult problems for the estate planner in Texas.¹⁵⁹ In the author's opinion, so long as the Service adheres to this position, litigation will be needed to define clearly the parameters of the ruling.

authority of the settled law of Texas,² that *whether the income be regarded as separate property of the wife or as community income from the wife's separate property, the taxpayer retained neither 'the possession or enjoyment of, or the right to the income from' the property* so as to make applicable Sec. 811(c)(1)(B), invoked by the commissioner and in part applied by the Tax Court.

2. Art. 4614, Tex. Rev. Stat. of 1925, Vernon's Ann. Civ. St. art. 4614; *Arnold v. Leonard*, 114 Tex. 535, 273 S.W. 799; *Hawkins v. Britton State Bank*, 122 Tex. 69, 52 S.W.2d 243; *In re Gutierrez*, D.C., 33 F.2d 987; *Whitney Hardware Co. v. McMahan*, 111 Tex. 242, 231 S.W. 694.

180 F.2d at 932 (emphasis added). *See also* *Pearson v. Campbell*, 62-2 U.S. Tax Cas. ¶ 12,120 (N.D. Tex. 1962) (held, without discussion, that transferred property is not subject to § 2036 of the Code merely because the income therefrom is community in nature); *Estate of Robert W. Wier*, 17 T.C. 409, 420-22 (1951), *acquiesced in* 1952-1 CUM. BULL. 4 (Commissioner agreed that outright gift of stocks did not cause one-half thereof to be includable in decedent's gross as a transfer with retained use and enjoyment (§ 2036 of the Code) even though the dividends received by the wife on the stocks were community in nature). *But see* *Commissioner v. Porter*, 148 F.2d 566, 568 (5th Cir. 1945).

156. TEX. FAM. CODE ANN. § 5.42 (1975). Query as to whether it would be possible to partition future dividends, interest or other income arising from the transferred property. *See* *Corrigan v. Goss*, 160 S.W. 652 (Tex. Civ. App.—El Paso 1913, writ ref'd). *Contra*, *Amarillo Nat'l Bank v. Liston*, 464 S.W.2d 395 (Tex. Civ. App.—Amarillo 1970, writ ref'd n.r.e.); *cf.* *Armstrong v. Tuberville*, 216 S.W. 1101, 1106 (Tex. Civ. App.—El Paso 1919, writ dism'd).

157. There is apparently no "conversion" of community property into separate property problem here similar to that present in calculation of the adjusted gross estate for marital deduction purposes. *See* INT. REV. CODE OF 1954, §§ 2056(c)(2)(B), (C).

158. *See generally* McKnight, *Commentary*, in *Texas Family Code Symposium*, 5 TEX. TECH L. REV. 346-55 (1974).

159. For a further discussion of the problems created by Rev. Rul. 75-504 see Tracy, *Inter-Spousal Gifts and Estate Planning in Texas After Rev. Rul. 75-504*, 3 COMM. PROP. J. 43 (1976).

